

Tutorial Letter 102/3/2020

Corporate Governance in Accountancy

AUE2602

Semesters 1 and 2

Department of Auditing

This tutorial letter contains important information about your module as well as additional questions you should work through as part of your studies.

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1 INTRODUCTION

In this tutorial letter we present you with a number of questions dealing with topics in your study guide. These questions give you the opportunity to test your knowledge on the topics as well as to prepare yourself for the examination. Solutions to these questions are provided in this tutorial letter.

For this purpose, you will be using the prescribed textbook *Graded Questions on Auditing* (2020) written by H Gowar and RDC Jackson (refer to Tutorial letter 101 for the list of prescribed textbooks). We are not allowed to give you copies of the questions since the authors have copyright over the questions. Please respect this request for ethical purposes. A complete set of solutions to *Graded Questions on Auditing* is unfortunately not made available to students and accordingly cannot be purchased.

It is important to note that these questions only cover certain aspects of the study material in the study guide and prescribed books. These are additional questions only. **Please note** that all the study material covered in the various topics is equally important and not only the aspects covered in this tutorial letter.

1.1 HOW TO ATTEMPT THE QUESTIONS

Once you have mastered the study material, refer to the topic list in this tutorial letter. Identify the question, go to *Graded Questions on Auditing* and attempt the question **as if you are writing a test under exam conditions**. After writing the “test”, mark it and score yourself.

Please refrain from merely reading the question and then memorising the solution. It is important that you know how to apply your knowledge to a practical; and if you only memorise solutions you will not be in a position to apply the theory to a given scenario.

The recommended time for each question is set out in *Graded Questions on Auditing*. You will notice that 1.2 minutes are available to earn 1 mark. It is important that when attempting to answer a question, you calculate at the start of the question how much time you have available to complete the question. For example, a question of 10 marks should be answered in a maximum time of 12 minutes. Remember that you will earn 1.5 marks for a valid point which is properly **described**. However, if we ask you to **list** a fact only one mark will be allocated.

2 TEXTUAL AMENDMENTS AND ADDITIONS TO TOPICS IN YOUR STUDY GUIDE

There are no textual amendments and additions to topics in your study guide.

3 QUESTIONS ON TOPICS IN YOUR STUDY GUIDE

The following questions apply to various topics in your study guide. Please attempt them after you have studied the particular topics and thereafter compare your solutions with the solutions given after the questions. Also keep in mind the time allocated to each question.

For this purpose, you will be using the prescribed textbook *Graded Questions on Auditing* 2020 by Gowar & Jackson (refer to Tutorial Letter 101 for the list of prescribed textbooks). **Please do not email or phone requesting the questions and their solutions. Lecturers are not**

allowed to give you copies of the questions or the solutions thereto (with the exception of solutions to questions included in this tutorial letter), since the authors have copyright over the questions and their solutions. Please respect this request for ethical purposes. A complete set of solutions to *Graded Questions on Auditing* is unfortunately not made available to students and accordingly cannot be purchased.

Topic 1 Corporate Governance and Statutory Matters

Supplementary Do questions on corporate governance

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing* (2020):

Question number	Topic	Marks
2.5	Requirements of sound corporate governance pertaining to the board of directors and board committees. Part A Part B (1,2,3,4,7,8)	49 marks
2.9	Requirements of sound corporate governance pertaining to the board of directors and board committees (Only b,c,d)	45 marks
2.23	Eligibility to be appointed to the audit committee	28.5 marks

Topic 2 Internal Control

Supplementary Do questions on internal control

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing* (2020):

Question number	Topic	Marks
4.15	Components of internal control, business processes (Only c, d, e, f)	25 marks
4.19	Components of internal controls	39 marks
4.26	General vs application controls, weaknesses in general controls	15 marks
4.28	Weaknesses in general controls (Only a)	46.5 marks

Topic 3 Business Cycles

There are no questions for this topic.

The theory and principles within this topic are tested as part of the business cycles (Topics 4 - 8).

Topic 4 Revenue and Receipts Cycle

Supplementary Do questions on the revenue and receipt cycle

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing (2020)*:

Question number	Topic	Marks
8.2	Functions in the revenue and receipts cycle.	15 marks
8.9	Internal controls in various functions of the revenue and receipt cycle.	61.5 marks
8.13	Weaknesses in the revenue and receipts cycle.	55.5 marks

Topic 5 Acquisitions and Payments Cycle

Supplementary Do questions on the acquisitions and payments cycle

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing (2020)*:

Question number	Topic	Marks
10.4	General vs application controls	12 marks
10.12	Weaknesses in the acquisitions and payments cycle	36 marks
10.15	Internal controls and application controls relating to the acquisitions and payments cycle (Only Part A [c and d])	24 marks

Topic 6 Inventory and Production Cycle

Supplementary Do questions on the inventory and production cycle

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing (2020)*:

Question number	Topic	Marks
11.1	Documents used in the inventory and production cycle.	12 marks
11.5	General vs application controls	16 marks
11.8	Weaknesses in a system of internal control in the inventory and production cycle. (Only b)	20 marks

Topic 7 Payroll and Personnel Cycle

Supplementary Do questions on the payroll and personnel cycle

For the purposes of this topic, answer the following questions from your prescribed textbook *Graded Questions on Auditing (2020)*:

Question number	Topic	Marks
9.1	Functions and risks in the payroll and personnel cycle	33 marks

9.8	Risks and computerised controls in the payroll and personnel cycle. (Only 1 and 4)	14 marks
9.12	Internal controls in the payroll and personnel cycle (Only c and d)	43.5 marks

Topic 8 Finance and Investment Cycle

Supplementary Do questions on the finance and investment cycle

For the purposes of this topic, answer the following question from your prescribed textbook *Graded Questions on Auditing (2020)*:

Question number	Topic	Marks
12.9	Weaknesses and recommendations in the finance and investments cycle.	30 marks

4 INSIGHT EDUCATION WEBSITE QUESTIONS ON THE BUSINESS CYCLES

Topic 4 Revenue and Receipts Cycle

Question	Marks
1. According to the insight education video on the Sales Cycle, what information should be contained on the pre-numbered, internally compiled invoice?	6 marks
2. According to the Insight Education videos, what cycle has the highest risk of theft and why?	3 marks

Topic 5 Acquisitions and Payments Cycle

Question	Marks
1. According to the Insight Education video on the purchasing cycle, what does the ordering manager do when he/she receives an order form?	6 marks

Topic 6 Inventory and Production Cycle

Question	Marks
1. What are the six (6) principles demonstrated in the production cycle video (Insight Education) that can be generalized and are the same to all the processes functioning within a company?	9 marks

Topic 7 Payroll and Personnel Cycle

Question	Marks
1. According to the Insight Education video on the salaries and wages cycle, name the three stages (not functions) within the cycle.	4½ marks

FEEDBACK ON SUPPLEMENTARY DO QUESTIONS

The authors have copyright over the questions and the solutions. Please do not email or phone requesting the questions and/or their solutions. Lecturers are not allowed to give you copies of the questions and/or the solutions thereto (with the exception of solutions to questions included in this Tutorial Letter). Please respect this request for ethical purposes.

Please note the mark allocation per point included in the suggested solutions may be different than in *Graded Questions* but is similar to what can be expected in an exam.

Topic 1 Corporate Governance and Statutory Matters

Feedback on supplementary *Do* questions on Topic 1

QUESTION 2.5 IN GRADED QUESTIONS

49 MARKS

Reference: King IV Report

PART A

30 MARKS

1. 1.1 The appropriate mix of knowledge, skills and experience needed to govern the company. (1)
- 1.2 The appropriate mix of executive, non-executive and independent non-executive directors to ensure that a balance of power is achieved, i.e. the board is not dominated by a single grouping or individual. (1) (The board should have a majority of non-executive directors, the majority of whom should be independent.)
- 1.3 The need to have sufficient qualified members to serve on board committees, e.g. the audit committee requires a minimum of three independent, non-executive members. (1)
- 1.4 Regulatory requirements, e.g. the Companies Act 2008 stipulates quorum requirements and JSE regulations require that listed companies appoint an (executive) financial director. (1)
- 1.5 Diversity requirements (experience, academic qualification, technical expertise, age, race and gender). (1)
2. 2.1 The chairperson should be an independent, non-executive director.(1)
Justification: this will promote a clear division of duties at top level in the company, with the power of the chairperson's position being vested in someone who is independent of the company, and hence likely to look after the interest of all stakeholders. (1)
3. 3.1 A nomination committee, should seek out, or be provided with, possible candidates for consideration. The nomination committee should consist solely of non-executive directors

with a majority of independent non-executive directors. The chairperson of the board should be a member of the nominations committee and may be the chairperson. (1)

3.2 These individuals (candidates) should be checked thoroughly for their suitability to act as directors (including a confirmation that they are neither ineligible nor disqualified from appointment in terms of Cosact 2008 Sec 69 or delinquent in terms of Cosact 2008 Sec 162. (1)

3.3 Before recommending a candidate for appointment, the board should consider

- the skills knowledge and experience of the candidate (1)
- the ethical integrity and reputation of the candidate (1)
- the existence of any actual or perceived conflicts of interest which the proposed candidate may have (1)
- the capacity of the candidate to dedicate the necessary time to discharge his duties particularly in the case of non-executive directors. (1)
- whether the appointment of a particular individual would help or hinder diversity requirements. (1)

3.4 The process for nomination, election and ultimately the appointment of directors should be formal and transparent. (1)

3.5 Recommendations to the shareholders for appointment should be made by the board as a whole, not just the nomination committee or the chairperson. (1)

3.6 A brief CV of each director standing for election or re-election at the AGM, should accompany the notice of the meeting. (1)

Note: Any Memorandum of Incorporation requirements relating to directors' appointments must be adhered to.

(Max 5 marks)

4. False. The Board should make the appointment. Note : the shareholders would first have to appoint the CEO as a director (if the individual is not already a director of the company). (1)

5. Disagree (1)

5.1 The members of the remuneration committee should be non-executive directors (Recommended practices King IV). (1)

5.2 The company secretary cannot be a director of the company. (1)

6. To be classified as an independent non-executive director, the director must

6.1 Not be a significant provider of financial capital, or ongoing funding to the company, or be an officer, employee or representative of such a provider (1)

6.2 Not be a participant in a share based incentive scheme offered by the company (1)

6.3 Not own shares in the company, the value of which is material to the personal wealth of the director (1)

- 6.4 Not have been in the employ of the company as an executive manager during the preceding three financial years or be a related party (e.g. husband) to such executive manager (1)
- 6.5 Not have been the designated (external) auditor, or a key member of the audit team during the preceding three financial years (1)
- 6.6 Not be a significant or ongoing professional advisor to the company (1)
- 6.7 Not be a member of the board or of executive management or a significant customer of or supplier to the organisation (1)
- 6.8 Not be a member of the board or the executive management of another company which is a related party to his company, e.g. a subsidiary of his company (1)
- 6.9 Not be entitled to remuneration which is contingent on the performance of the company (1)

(max 6 marks)

- 7. False. The chairperson of the remuneration committee should be an independent non-executive director. (1)
- 8. At least every two years. (1)
- 9
 - 9.1 Incorrect (not a function of the audit committee). (1)
 - 9.2 Correct (may also form a committee or engage an independent party). (1)
 - 9.3 Incorrect (all directors should be evaluated). (1)
 - 9.4 Correct (recommended by King IV). (1)
 - 9.5 Incorrect (King IV recommends an annual evaluation). (1)
 - 9.6 Incorrect (disclosure should be made in the manner in which the company discloses its compliance with the principles of King IV, possibly in the integrated report). (1)

PART B**19 MARKS**

- 1.
 - 1.1 Executive directors are involved in the management of the company, they have day-to-day responsibilities in running the company e.g. sales, marketing, manufacture. Non-executive directors do not have these responsibilities; they are appointed to provide independent judgement and advice on issues facing the company. (1)
 - 1.2 Executive directors are “full-time” salaried employees, non-executive directors are not; they are remunerated in the form of fees. (1)
 - 2. No: significant or ongoing professional advisors are not independent of the company and are specifically “excluded” from being classified as independent by King IV. (1)
- No: the company’s auditor is prohibited from being a director (of any kind) by Sec 90 of the Companies Act 2008. (1)
- No: in terms of King IV, individuals who have been employed in an executive capacity by the company within the previous three years cannot be designated as independent (he could be appointed as a non-executive director). (1)

Maybe: Being a shareholder only excludes a director from being classified as independent if the value of the holding is material to the director. (1)

3. A board committee is a group of people appointed by the board of directors to assist the board in meeting its responsibilities in respect of a particular activity or function, e.g. nominations committee, audit committee. Although individuals other than directors can be appointed to serve on some committees, they would have no power to vote on decisions to be taken by the committee. (1)
4. To be successful a board committee should
 - 4.1 be formally established, with terms of reference criteria for composition, role and responsibility, tenure of members authority to act, etc (1)
 - 4.2 contain the necessary skills and expertise to deal with the matters it was created for e.g. audit committee must be financially literate (1)
 - 4.3 be independent e.g. majority of members should be non-executive and be chaired by independent non-executive directors, and the committee should be entitled to take outside professional advice (1)
 - 4.4 be regularly evaluated in terms of its performance in carrying out its mandate (accountable for its performance) (1)
 - 4.5 be given the necessary right of access to be able to carry out its mandate, and be delegated the necessary authority to make recommendations/decisions (1)
 - 4.6 where necessary, operate holistically (integrated and collaborative) with other committees (1)

(max 4 mark)
7. The LID should fulfil the following functions:
 - 7.1 lead in the absence of the chairperson. (1)
 - 7.2 serve as a sounding board for the chairperson. (1)
 - 7.3 act as an intermediary between the chairperson and other members of the board. (1)
 - 7.4 deal with shareholders' concern where contact through the normal channels has failed to resolve concerns, or where such contact is inappropriate. (1)
 - 7.5 strengthen independence if the chairperson is not an independent non-executive director. (1)
 - 7.6 chair discussions where the chairperson has a conflict of interest. (1)
 - 7.7 lead the performance appraisal of the chairperson. (1)

(max 5 marks)
8.
 - 8.1 False (independence problem) (1)
 - 8.2 False (all members should be non-executive directors) (1)
 - 8.3 False (not all members need to be independent non-executive directors) (1)

Comments:

Know and understand the principles of the King IV Report to be able to apply your knowledge in practical scenarios. This is a very good question to test your knowledge on Corporate Governance and the King IV Report.

Refer to the tables in learning unit 1.3.3 of your study guide, which summarise important principles regarding the board of directors and board committees. It is still important to refer to the King IV Report as well.

You are not required to include the specific reference to the principles of the King Report as in the suggested solution; you only need to state what the principles are/require.

QUESTION 2.9 IN GRADED QUESTIONS**45 marks****Reference:** King IV Report**(b) Composition of the board:**

1. The roles of chair and chief executive officer are held by different people, which is in accordance with principle 7. (1½)
2. However, the chair, Virat Amla, does not appear to be an independent, non-executive director as recommended by the principle 7.31. (1½)
3. It appears that no lead independent non-executive director has been appointed by the board. One of the functions of a “lead independent, non-executive director” is to act as chair in situations where the chair’s independence is questionable or impaired (the chair is conflicted) (principle 7.32). (1½)
4. The fact that the deputy chair is also the senior executive officer is not in accordance with the recommendations of the King IV Report.
 - 4.1 The roles of CEO and chair should be independent of each other, but whenever the deputy chair acts as chair, this requirement will not be met (principle 7.34). (1½)
 - 4.1 It will present a problem with the succession plan as the deputy chair should not be appointed chair until three years have elapsed since his or her resignation as CEO (principle 7.34). (1½)
5. There is an appropriate mix of executive and non-executive directors on the board, particularly in view of the fact that non-executive directors are in the majority and four of the six non-executive directors are independent non-executive directors (principle 7.8). (1½)
6. Although he should not be the deputy chair, the fact that the CEO is on the board complies with the King IV recommendations that the CEO be appointed to the board. King IV also requires that “at least one other executive director be appointed to the board”. This requirement has been satisfied (principle 7.9). (1½)
7. Judging by the experience, occupations and qualifications, gender and race of the directors there is enough collective skill, knowledge and experience for the board to meet its responsibilities and satisfy diversity targets (principle 7.7). (1½)
8. There also appears to be an appropriate number of directors to be an effective board but some difficulty may arise with satisfying committee requirements, e.g. audit. (1½)

(c) Composition of the audit committee:

Name	Eligible	Reason	Attend meetings
Virat Amla	No (½)	Chair of the board and not independent (½)	May attend by invitation (½)
Frans Klewsner	No (½)	Executive director (½)	No (½)
Noddy Nkwe	No (½)	Executive director (½)	No, but may be invited for specific matters on the agenda (½)
Mary Smith	No (½)	Executive director (<i>Note 1</i>) (½)	Not normally (½)

Marshall Gibbs	No (½)	Executive director (<i>Note 1</i>) (½)	Not normally (½)
Mills Ndou	No (½)	Executive director (<i>Note 1</i>) (½)	Not normally (½)
Eric Hougaard	No (½)	Not independent non-executive director (½)	Not normally (½)
Victor Botha	No (½)	Not a director - company secretary (½)	Yes, to record minutes (½)
Ashley Willemse	No (½)	Not a director - chief audit executive (½)	May attend by invitation (½)
Russell Brent	Yes (½)	Independent non-executive director (½)	Only if appointed (½)
Serena Court	Yes (½)	Independent non-executive director (½)	Only if appointed (½)
Bongi Zulu	Yes (½)	Independent non-executive director (½)	Only if appointed (½)
Chris Eubank	Yes (½)	Independent non-executive director (½)	Only if appointed (½)

Note 1: The presence or lack of financial expertise of these directors does not affect their eligibility, it is the fact that they are executive directors.

(d) Composition of the audit committee:

Of the thirteen individuals listed, only four are eligible for appointment as none of the others satisfies the basic requirements to be appointed: independent and non-executive and a director. (1½)

Of the four available candidates:

1. Russell Brent satisfies the basic requirements and is likely to have the necessary expertise, skills, competency and financial literacy to fulfil his function on the audit committee and ask probing questions about the company's financial reporting and related processes, risks and internal controls. I would recommend his appointment. (1½)
2. I would not recommend Serena Court as it is very unlikely that she would have the necessary knowledge of financial reporting to fulfil the role and duties of an audit committee member. In all likelihood she sits on the board to provide fashion insights to the children's clothing market. (1½)
3. This leaves just Bongi Zulu and Chris Eubank. They both clearly have business experience and probably some understanding of the necessity for and role of an audit committee. (1½)
4. However, there is no guarantee that simply because she is the chair of a company that Bongi Zulu will have the necessary financial expertise or knowledge of integrated reporting to make a meaningful contribution. (1½)
5. Likewise Chris Eubank is retired and there have been major developments in financial reporting matters. Will he be up to date? Furthermore being a "business" man does not equate to having the necessary expertise on reporting matters. He may be experienced in other aspects of business. (1½)
6. With regard to the necessary expertise required by the audit committee, King IV requires a collective ability. Even though Russell Brent appears to have the ability, he cannot be a "one man band". The other members must be able to contribute to the audit committee in meeting its responsibility. (1½)

- 7 I would therefore recommend that one of either Bongi Zulu or Chris Eubank be appointed (preferably Bongi Zulu on the evidence available) and that the company appoint an additional independent non-executive director who has the specific expertise needed to give the committee the collective knowledge, skills and competency it requires. (1½)

Comments:

For question 2.9 (b) both compliance and non-compliance should be covered in your answer. Note that the required did not specifically state this, therefore you deal with both.

Know and understand the principles of the King IV Report to be able to apply your knowledge in practical scenarios. This is a very good question to test your knowledge on Corporate Governance and the King IV Report. If you are able to do this question, you should not have a problem in the assignments and exams!

Refer to the tables in learning unit 1.3.3 of your study guide, which summarise important principles regarding the board of directors and board committees. It is still important to refer to the King IV Report as well.

You are not required to include the specific reference to the principles of the King Report as in the suggested solution, you only need to state what the principles are/require.

QUESTION 2.23 IN GRADED QUESTIONS

28.5 marks

Reference: King IV Report and Companies Act of 2008

Eligibility to be appointed to the audit committee:

1. Gambhir Gull: - Not eligible. As company secretary he may not be a director of JayB Ltd, which is a requirement to be elected to the audit committee (Companies Act: section 94). (1½)
2. Rod Dodger: - To be appointed to the audit committee, the individual concerned must be a director of JayB Ltd (Companies Act: section 94). He would therefore have to be appointed (in terms of the Companies Act and requirements of the MOI) as a non-executive director. (1½)
 - He appears to be independent and has the advantage of being a corporate law expert, which would be useful. (1½)
 - Provided the financial expertise of the audit committee as a whole will enable the committee to fulfil its function, any lack of financial expertise on the part of Rod Dodger should not be a problem. (1½)
 - However, whether he would have the necessary knowledge of the company (as a new director) or the requisite knowledge of financial risk, financial reporting, IFRS and global sustainability reporting initiatives, is doubtful. (1½)
3. Karl Zeiss: - Although Karl Zeiss is a non-executive director (and presumably independent), King IV recommends that the chair of the board not be a member of the audit committee. If he is to be a member of the audit

committee and chair of the board, it would threaten his objectivity and lead to the perception that the audit committee is not truly independent. (1½)

- He may be invited to attend meetings. (1½)

4. Terry Ticker: - He is not eligible for appointment for a number of reasons. To be on the audit committee he would need to be a director but as his firm is the auditor of JayB Ltd, Section 90 of the Companies Act 2008 disqualifies him from being a director. (1½)
5. Aaron Khumalo: - He is not appointable as he is not a director (Companies Act, section 94). (1½)
- Even if he were appointed a director, he is still involved in the “day to day business” of JayB Ltd and therefore not independent or non-executive (Companies Act, section 94 and King IV) and therefore cannot be appointed despite the fact that he has the required financial literacy. (1½)
6. Klark Gayble: - He is appointable as he is an independent non-executive director with the necessary financial expertise and experience. (1½)
7. Theuns Jordaan: - He is not a director of JayB Ltd so on this count, is not appointable. (1½)
- He is an executive director of MayB (Pty) Ltd which is a subsidiary of JayB Ltd (and therefore a related company) so is disqualified from being appointed to the committee by Companies Act, Section 94(4)(ii). (1½)
- It is unlikely that he would have the necessary financial expertise or knowledge of financial/sustainability reporting, and risk governance. (1½)
8. Jennifer Jacobs: - She would have to be appointed to the board as a director (non-executive). (1½)
- She probably does not have the necessary financial knowledge and experience requirements but is independent of JayB Ltd and could therefore serve as an independent non-executive director on the audit committee, provided the other members have the necessary skills (which it appears will be the case if Robbie Wessels remains and Klark Gayble and (possibly) Rod Dodger are appointed). (1½)
9. Rod Grind: - If a reasonable and informed third party would conclude that Rodds (Pty) Ltd (which is “related” to Rod Grind) is a material supplier to the extent that Rod Grind’s integrity, impartiality or objectivity might be compromised by his relationship to both companies, then he would be disqualified in terms of Companies Act, Section 94(4)(b)(iii) and would not be regarded as an independent non-executive director in terms of King IV and should therefore not be appointed. (1½)

- The fact that he also has a 4% shareholding does not automatically exclude him unless the value of the shareholding is material to Rod Grind in which case his independence would be, or would at least be seen to be, impaired. (1½)

- As a CA(SA) and former chairman of JayB Ltd, he is likely to have the necessary financial knowledge and experience. He is already a non-executive director, it is only his independent status which is in question. (1½)

Comments:

With this question, you had to incorporate your knowledge of the Companies Act as well as the King IV Report.

Topic 1 being Corporate Governance will count between 20% and 30% of your final examination. Thus, please ensure that you spend adequate time on studying this topic.

Topic 2 Internal Control

Feedback on supplementary *Do* questions on Topic 2

QUESTION NUMBER 4.15 IN GRADED QUESTIONS

25 MARKS

- c) In terms of ISA 315 (Revised), internal control is defined as “the process designed, (1) implemented and maintained (1) by those charged with governance, management and other personnel, (1) to provide reasonable assurance about the achievement of the entity’s objectives (1) with regard to
- the reliability of the entity’s financial reporting (1)
 - the effectiveness and efficiency of its operations, and (1)
 - its compliance with applicable laws and regulations”. (1) Maximum (5 marks)
- d) The components of internal control are
- the control environment - example (v) (1½)
 - risk assessment - example (iv) (1½)
 - the information system - example (i) (1½)
 - control activities - example (ii) (1½)
 - monitoring of controls - example (iii) (1½)
- e) Risk identification and assessment may be addressed by (usually) a combination of the following
1. The appointment of competent and knowledgeable risk committees and/or risk officers. (1½)
 2. The engagement of external risk consultants. (1½)
 3. The use of risk models. (1½)
 4. Regular meetings at divisional, departmental and sectional level, to consider the risks at those levels (and create an environment of risk awareness). (1½)

5. Strategy meetings involving senior management to assess risk at an overall level. (1½)
- f)
1. An information system is a combination of machines, computers, software, people and data. (1)
 2. Business processes are the activities which are designed to purchase, produce, sell and distribute the company's products, ensure compliance with laws and regulations, and record information. (1)
 3. The information system and related business processes work together to
 - 3.1 Initiate, record, process and report transactions. (1)
 - 3.2 Capture events and conditions other than transactions (e.g. impairments). (1)
 - 3.3 Accumulate, record, process and summarise information for the preparation of the financial statements. (1)

QUESTION NUMBER 4.19 IN GRADED QUESTIONS

22 MARKS

Reference: Jackson & Stent (2016:5/5 - 5/18)

Components of internal controls and types of control activities:

Nr.	Component of internal control	Category (types) of control activity
1.	Control environment (1½) Reason: Participation by those charged with governance and communication and enforcement of ethical values: The board (including the chairman) is actively involved in developing a strong sense of ethics in the company (1½)	
2.	Control Activities (1½) Reason: This control is designed to protect the company's assets (intellectual property), e.g. research data, formulae for medications, etc from theft/misuse by research personnel. (1½)	Access/Custody Control (1½)
3.	Information system (1½) Reason: The cost accountant and his specialised software are part of the information system in place designed to produce valid (occurred and authorized), accurate and complete information pertaining to expenditures on research (1½)	
4.	Control Activities (1½) Reason:	Comparison and Reconciliation (1½) OR Performance review (1½)

Nr.	Component of internal control	Category (types) of control activity
	<p>Comparison and Reconciliation: This amounts to a comparison of actual research costs incurred against budgeted research costs to identify any overspends, investigate the causes and resolve any weaknesses giving rise to the overspend (prevent any similar overspends from occurring). Underspends will also be followed up where they have occurred unexpectedly. (1½)</p> <p>Performance review : This also amounts to a review by the directors of the performance of the research department in controlling costs. (1½) <i>Note: The direct involvement of two important directors is also part of creating a sound control environment.</i></p>	
5.	<p>Control Activities (1½)</p> <p>Reason: Authorisation/approval: The meeting of the two directors is an authorisation process at which the financial director approves the write-off of a debtor(s) where necessary. (1½)</p> <p>Isolation of responsibility: Requiring the directors to sign the journal entry supporting documentation isolates the responsibility of the two directors to apply the company's bad debt policy and to acknowledge that they have done so. (1½)</p> <p>Performance review: In effect, this meeting is also a review of the credit management function. (1½)</p>	<p>Approval authorisation (1½) OR Isolation of responsibility (1½) OR Performance review (1½)</p>
6.	<p>Risk assessment process (1½)</p> <p>Reason: This meeting of a committee of the board will be part of the identification of, evaluation of, and response to, the strategic risks (new trends and potential market developments) and compliance risks (regulatory environment) facing the company. (1½)</p>	
7.	<p>Control Activities (1½)</p> <p>Reason: This is a control designed to prevent the physical deterioration of one of the company's assets, i.e.</p>	<p>Access/Custody Control (1½)</p>

Nr.	Component of internal control	Category (types) of control activity
	inventory. (1½)	
8.	Monitoring of controls (1½) Reason: A customer phone-in service is a means of monitoring how certain aspects of the internal control process are doing over time. Analysis of the calls from customers in this instance, will help the company with determining whether they are adequately addressing operational risks such as distribution of products as well as market-related risks (pricing and product demand). Obviously, some of the information provided by customers will not relate specifically to the internal control process. (1½)	
9.	Control Activities (1½) Reason: This “segregates” the custody of the inventory from the record keeping relating to that inventory, which in turn contributes to the protection (custody) of the inventory. Neither the custodians of the inventory (the warehouse manager) nor the pickers, can amend the records to cover up shortage of inventory due to theft, etc. (1½)	Segregation of duties (1½)

Comments:

To be able to answer this question, you need to know the different components of internal control as well as the different categories of control activities.

This question has been provided to test your understanding of the theory specifically relating to internal control components in topic 2. You should be able to apply the theory to scenario.

Remember that it is very important for you to have a good understanding of this foundational knowledge, as it will prepare you for later studies in auditing.

QUESTION 4.26 IN GRADED QUESTIONS

15 MARKS

Reference: Jackson & Stent (2016:5/5 - 5/18)

General vs application controls, weaknesses in general controls

1. Application (1½)
2. Application (1½)
3. General – continuity of operations (risk assessment) (1½)

4. General – programme change controls (1½)
5. Application (1½)
6. General – access control (physical) (1½)
7. General – continuity of operations (1½)
8. Application (1½)
9. Application (1½)
10. General – control environment. (1½)

Comments:

To be able to answer this question, you need to know the difference between an application control and a general control.

General controls apply to all areas of the organisation including the IT infrastructure and support service.

Application controls refer to the transactions and data relating to each computer-based application system; therefore, they are specific to each application.

What is application software: *Programmes that direct the computer in performing specific user-related data-processing tasks; may be called application programmes, user programmes, or problem programs. Examples are weekly payroll, order-processing and sales reports programmes.*

QUESTION 4.28(a) IN GRADED QUESTIONS

46.5 MARKS

Reference: Jackson & Stent (2016:8/7 - 8/25)

1) Access Controls

1. Security policy

It appears that there is no formal security policy in place. (1½) Two important principles of a sound security policy are the implementation of **least privilege** and **logging** (the use of logs).

1.1 Least privilege means that individuals are given access to only those aspects of the system/application that are necessary for them to do their jobs. This is usually controlled by the comprehensive use of user ID's and passwords controlled by an access table which defines exactly which functions an employee is given access to and what kind of access is given. It appears that the entry of a user ID and password provides access to the system and all applications. (1½)

1.2 Adherence to the principle of logging requires that the computer's ability to record activity should be extensively incorporated. Presley Pine was very vague about the

use of logs, a number of which could and should be used frequently by Presley Pine himself. For example, a log of access violations should be generated **and** reviewed by Presley Pine. This is an important access control. (1½)

2. **Physical Access**

- 2.1 Access control to the IT department is inadequate. (1½)
- The door to the room has been left open for no valid reason. (1½)
 - Unauthorised persons (e.g. the stationer) are allowed unaccompanied access to the IT department. (1½)
 - During this time the door is propped open and anyone can enter. (1½)
 - It is not necessary to have general IT staff in with the equipment, this increases traffic flow and the risk of unauthorised access. (1½)

3. **Logical access**

- 3.1 As discussed under security policy, the use of access profiles and access tables is totally inadequate to control modes of access to employees, e.g. no access, read only, read and write. (1½)
- 3.2 All terminals have logical links to all applications on the system allowing any user terminal to access any application and its functions. (1½)
- 3.3 Password controls are inadequate. (1½)
- They are obviously not kept confidential as Sally Meranti's password was given to me without concern. (1½)
 - Password controls are inadequate. (1½)
 - Short (they are only two characters long, should be at least six). (1½)
 - Not unique (Sally Meranti has used her initials, which is rather obvious). (1½)
 - Made up of letters only, containing no numbers, symbols, etc. (1½)

2) **Continuity of Operations**

1. **Risk assessment**

- 1.1 It is clear that there is no ongoing assessment of IT risk. There are numerous risks which face a company's IT system, a number of which can seriously affect continuity of operations. (1½)
- 1.2 Presley Pine's attitude to disaster recovery suggests that he does not understand the importance of risk assessment and/or that he is not competent to carry out this function. (1½)
- 1.3 The fact that there is no computer steering committee to support and guide Presley Pine, is also a weakness as this committee should play an important part in IT risk assessment, particularly risks which may threaten continuity of operations. (1½)

2. **Physical security**

- 2.1 The computer facilities are not protected against fire. (1½)
- The fire extinguisher is not in its correct place and is not functional as the extinguisher's nozzle is being used as a flower vase. (1½)

- If doors are left open, temperature and humidity controls are not effective. (1½)

2.2 Using a server as a shelf for a flower vase is unacceptable, as dirt and water could spill from the vase and damage the processor. (1½)

3. **Disaster Recovery**

No detailed and tested disaster recovery plan exists to inform staff of the procedures to follow in the event of a disaster. (1½)

3.1 Presley Pine's explanation for the lack of a disaster recovery plan is invalid. (1½)

- Regardless of the size or complexity of the processing facility, important data can still be lost and business disrupted if a disaster occurs in any size of business. (1½)
- Disasters can strike at any time, and based on Presley Pine's lack of competence, the company has just been lucky. (1½)
- Many causes of disasters have nothing to do with employee honesty e.g. a major unprotected power surge. (1½)
- The same applies to the reliability of hardware – reliable hardware can still be damaged or stolen! (1½)

4. **Back-up strategies**

4.1 Back-up of data is an integral part of a disaster recovery and thus continuity of operations. The fact that Presley Pine, as IT manager, does not know this or (more likely) chooses to disregard it for invalid reasons, is a significant weakness which severely threatens the continuity of operations. (1½)

5. **Improvements to applications**

5.1 The fact that IT staff is encouraged to “experiment and explore” the application software presents a significant risk to the contamination or destruction of data – a threat to continuity of operations. (1½)

Comments:

This questions deals with two categories of the general controls. The categories of general controls are control environment, systems development and implementation controls, access control, continuity of operations, system software and operating controls and documentation of the controls.

Access:

Unauthorised logical access (which really means gaining unauthorized access to data, and programmes electronically stored through a workstation/terminal) can result in the destruction of data, the manipulation of data or the theft of data and programmes.

Access to all aspects of the system must be controlled:

- * hardware,
- * computer functions at system level, (accessing the computer system itself)

- * computer functions at application level, (accessing a specific application or module within an application)
- * data files/databases,
- * utilities,
- * documentation (electronic or hard copy),
- * communication channels.

Continuation of operations:

These controls are aimed at protecting computer facilities from natural disasters (e.g. flooding or fire), as well as from acts of destruction, attack or abuse by unauthorised people. Please take note that a disaster recovery plan and backup plan strategies are two different controls that should be implemented. You should know the difference.

Topic 4 Revenue and Receipts Cycle

Feedback on supplementary *Do* questions on Topic 4

QUESTION NUMBER 8.2 IN GRADED QUESTIONS

15 marks

Reference: Jackson & Stent (2016:10/2 - 10/5)

Functions in the revenue and receipts cycle

1. Credit management (1)
2. Receipts mailroom/cashier (1)
3. Receipts mailroom/cashier (1)
4. Recording of receipts (1)
5. Warehouse (1)
6. Despatch (1)
7. Order department – receiving customer orders (1)
8. Order department – receiving customer orders/or warehouse (1)
9. Order department – sales authorization (1)
10. Order department – sales authorization (1)
11. Order department - receiving customer orders (1)

12. Receipts mailroom/cashier (1)
13. Credit management (1)
14. Despatch (1)
15. Credit management (1)

Comments:

To answer the question you should know the functions and control measures that normally take place in the revenue and receipts business cycle as described in your text book Jackson & Stent (2016:10/2 - 10/5; 10/10 - 10/19)

QUESTION 8.9 IN GRADED QUESTIONS

61.5 marks

Reference: Jackson & Stent (2016: 10/10-10/19)

Internal controls of various functions in the revenue and receipts cycle

1. Receiving customer orders

1. Marcia Oliver should be responsible for receiving all customer orders i.e. customers arriving to place orders should be attended to by her, phone orders should be put through to her and faxed/posted orders handed to her. (1½)
2. All orders should be recorded on pre-printed, sequenced, multi-copy internal sales orders. (1½)
3. The ISO should be designed to enhance accuracy of recording e.g. the codes and descriptions of the fifteen lines of bricks sold by Stonebrix (Pty) Ltd should be shown on the ISO. Each line should have a space in which the quantity ordered and price can be entered by Marcia Oliver. (1½)
4. Marcia Oliver should have a list of approved customers and their account numbers and a price list. (1½)
 - 4.1 She should also be given a copy of the “daily stock report” every morning. This will enable her to check stock availability when an order is placed. (1½)
5. On receiving an order (by whatever means), Marcia Oliver should confirm that the contractor placing the order is on the approved customer list. If not, the customer must be referred to Preggs Naidoo, the credit controller. No ISO will be made out for non-approved customers. (1½)
 - 5.1 She should also check the “daily stock report” and inform the customer accordingly. If the customer wishes to be placed on “backorder” Marcia Oliver should note this in a back order register. (1½)
6. Where a contractor’s employee comes in personally to place the order, he should check all the details recorded on the ISO (e.g. contractor name, contact details, delivery address, description and quantity of bricks ordered). Where possible a customer order reference should be entered but in any event, the contractor’s employee should sign the ISO as authority for the order. (1½)

7. Where the order is taken over the phone, Marcia Oliver should confirm all order details, (as in 6 above) by reading back to the customer placing the order. Marcia Oliver must insist upon a customer order reference or identification of the person placing the order. (1½)
8. Any faxed or posted orders should be attached to copy 3 of the ISO (see below) once the ISO has been completed by Marcia Oliver. (1½)
9. Marcia Oliver should make out the ISO in triplicate, and once she is satisfied that it is accurate and complete, she should sign it. (1½)
10. The ultimate distribution of the ISOs will be
 - 10.1 Copy 1 – sent to Preggs Naidoo for sales authorization, and then to Bridge Zuma
 - 10.2 Copy 2 – sent to Petra Petersen in accounting
 - 10.3 Copy 3 – to be filed numerically and to remain with Marcia Oliver. (1½)
11. At a later stage, a copy of the despatch note should be sent to Marcia Oliver. She should match the despatch note to its ISO and follow up on any ISOs which have not resulted in dispatches. (1½)

Note: This control is also carried out by Petra Peterson (see invoicing) but for a slightly different reason. As orders are placed with Marcia Oliver, it is a good idea to keep her informed as customers will probably phone her to enquire about the status of their order.

12. She should also regularly check on the status of backorders, notifying the customer as soon as an order can be filled. (1½)

2. Sales authorisation

1. On receiving the ISOs, Preggs Naidoo should confirm by reference to the contractor's (debtor) account and information file that the contractor is not in breach of his credit limits and terms and will not be put in such a position if the contractors order is processed. (1½)
 - 1.1 If the contractors' terms/limits will be exceeded, Preggs Naidoo should contact the contractor to resolve the issue. (1½)
2. If the creditworthiness issue cannot be resolved to the satisfaction of Preggs Naidoo (who should have some discretionary powers) and John Stone, the order should go no further. (1½)
3. If Preggs Naidoo is satisfied with the creditworthiness of the customer, he should authorize the sale by signing and dating the ISO. (1½)
 - 3.1 Any ISOs which he does not authorize, should be filed and retained by Preggs Naidoo and followed up as the situation develops, e.g. the contractor pays his account. (1½)
4. The authorised ISOs should be returned to Marcia Oliver and an authorised copy of the ISO should be handed (brickyard controller) to Bridge Zuma for processing. (1½)
5. Where a potential customer is referred to Preggs Naidoo, credit application procedures should be carried out. (1½)
 - 5.1 A credit application form must be completed by the contractor. Banking details, trade reference, financial information, etc should be provided. (1½)
 - 5.2 Preggs Naidoo should follow up by contacting trade references, credit bureaux to the extent that he requires to assess the creditworthiness of the contractor. (1½)

5.3 Preggs Naidoo should set the terms and limits for the contractor and have them approved by John Stone or Shannon Green. (1½)

3. Brickyard and Despatch

1. On receipt of the authorised ISO, Bridge Zuma should initiate the processing of the order by making out a pre-printed, numerically sequenced, multipart despatch note as per the details of the ISO, including a cross reference to the ISO number.

Copy 1 and 2 – to accompany the delivery

Copy 3 – to remain with Bridge Zuma filed in numerical order with the corresponding ISO.

Copy 4 – sent to Marcia Oliver for matching to ISO. (1½)

2. Bridge Zuma and the driver transporting the delivery, should supervise the loading of the truck. On completion, the driver should sign copy 3 of the despatch note (or notes if he is making more than one delivery) to acknowledge that he has taken responsibility for the bricks. (1½)
3. As indicated, copy 1 and 2 of the despatch note should be taken by the driver. When the driver leaves the premises, the security guard should check the load on the truck and agree it to the despatch notes. These should be stamped/signed by the guard to acknowledge the procedure has been carried out. (1½)
4. On delivery, both copies of the despatch note should be signed by the contractor to acknowledge the delivery. The driver should also sign both copies. (1½)
 - 4.1 Copy 1 of the despatch note should be kept by the customer.
 - 4.2 Copy 2 should be retained by the driver as proof of delivery. (1½)
5. On returning to the brickyard, the driver should pass copy 2 of the despatch note to Petra Peterson (the bookkeeper). (1½)

Note: A further control which could be implemented is the introduction of a delivery list to be drawn up by Bridge Zuma for the driver. This is usually only necessary when drivers are making numerous deliveries each time they go out. This is unlikely when delivering bricks.

4. Invoicing

1. On receipt of the despatch note from the driver, Petra Peterson should match it to her copy of the ISO sent to her by Marcia Oliver and agree the details. (1½)
2. Once ISOs have been matched to despatch notes, they should be removed from their temporary file and filed with the despatch note in the numerical sequence of the despatch notes. (1½)
 - 2.1 Before creating invoices, Petra Peterson should sequence check the despatch notes and follow up on any missing numbers. (1½)
3. Petra Peterson should timeously complete a pre-printed, numerically sequenced, multi-part invoice. (1½) She should
 - 3.1 Agree the details on the ISO and despatch notes (as above) including the details of the customer per the debtors' ledger. (1½)

- 3.2 Confirm prices quoted to the customer against the official price list. (1½)
- 3.3 Cross-reference the invoice to the despatch note. (1½)
- 3.4 Sign the invoice. (1½)
4. Carmen Twitty (or Marcia Oliver) should check the invoices prepared by Petra Peterson to confirm
 - 4.1 Prices, extensions, casts, VAT calculations, are correct. (1½)
 - 4.2 Invoices are cross-referenced to the despatch notes and that all despatch notes have resulted in an invoice. (This can be done by cross-referencing the sequentially filed despatch notes held by Bridge Zuma to the invoices). (1½)
5. The invoices should be used as follows:

Copy 1 – sent to the customer.

Copy 2 – filed alphabetically with the corresponding ISO and despatch note.

Copy 3 – filed numerically and used by Petra Peterson to write up the sales journal. (1½)
6. On a frequent and regular basis, Petra Peterson should follow up on any (non-recent) ISOs held in her temporary ISO file to determine why no matching despatch note has been received. (1½)
7. Every month Shannon Green should sequence check the file of invoices and the sales journal for breaks in sequence. (1½)

Comments:

Did you notice how the solution used the information provided in the scenario and did not just copy and paste from the text book. The text book is there to provide the basis from which you should work, but if you understand the concepts and how the internal controls work, you can apply this theory to almost any scenario.

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

QUESTION 8.13 IN GRADED QUESTIONS

30 marks

Reference: Jackson & Stent (2016: 10/10-10/19)

Weaknesses and explanations in the receiving of orders function:

No.	Weakness	Explanation
1.	An inventory availability check is not done prior to accepting an order. (1½)	- As customers will not be informed of inventory availability problems: * back-orders may not be initiated, resulting in lost sales. (1½) * goodwill will be eroded as Quik Tyre (Pty) Ltd bases its marketing on quick delivery. (1½)
2.	Customers are not required to quote a buying reference number when placing	- Customers may reject deliveries on the basis that:

No.	Weakness	Explanation
	orders. (1½)	<ul style="list-style-type: none"> * they do not know to which order the delivery relates (1½) or * that they did not place the order. (1½)
3.	Donny Lopez does not confirm: <ul style="list-style-type: none"> * customer details, e.g delivery addresses, when customer details appear. * customer order details once the order is placed (i.e. code and quantity). (1½) 	<ul style="list-style-type: none"> - Failure to confirm customer and order details may result in: <ul style="list-style-type: none"> * deliveries to incorrect addresses. (1½) * incorrect invoicing. (1½) * incorrect goods being supplied (type and quantity). (1½)
4.	The software does not automatically link the tyre code with the description when the tyre code is entered. (1½) (minimum entry principle)	<ul style="list-style-type: none"> - Having to enter the tyre code and description may result in Donny Lopez inserting an incorrect description next to the tyre code. This may result in confusion/delay/incorrect deliveries when the tyres are picked for delivery. (1½)
5.	Controls over the log of overrides are inadequate: <ul style="list-style-type: none"> * there should be no write access at all to the log. (1½) * the financial accountant does not have read access. (1½) * the file is not reviewed on a daily basis by Gene Kelly. (1½) 	<ul style="list-style-type: none"> - The object of having a computer generated log is to provide an independent and unalterable record of what activity has taken place on the system for review purposes. Donny Lopez can conceal any overrides which are invalidly given by deleting them from the file thus negating the control. (1½) - The financial accountant is unable to make an independent check on the reasons for overriding an important control. (1½) - Donny Lopez may regularly override the “in arrears” control without justification and without the knowledge of his superiors. (1½) <p>Note: All the above may result in increased bad debt write-offs.</p>
6.	The control over extension of credit to customers is very weak: <ul style="list-style-type: none"> * there is no follow up on the application for credit (even the references). (1½) * no credit limits or terms are set. (1½) * Donny Lopez, in effect, is also able to extend credit. (1½) 	<ul style="list-style-type: none"> - Before granting credit, Gene Kelly should evaluate the creditworthiness of the proposed customer (1½) by: <ul style="list-style-type: none"> * at least following up with the trade references provided or with a credit bureau. (1½) - Simply determining whether all information requested has been provided is completely worthless unless it is verified. (1½) - The idea behind carrying out the creditworthiness evaluation is to decide on the appropriate credit terms and limits

No.	Weakness	Explanation
		<p>which can be granted to the proposed customer to prevent losses from the customer not paying amounts owed. As this does not happen, a customer can make unlimited purchases. (1½)</p> <ul style="list-style-type: none"> - As Donny Lopez can override the “arrears” control he is actually able to extend credit to a customer by allowing the customer to make purchases despite being in arrear. (The “in arrear” control is designed to control the granting of excessive credit.) (1½)
7.	<p>Control over masterfile amendments is inadequate as there is a total lack of division of duties for approving and recording masterfile amendments and the fact that Donny Lopez can also authorise and process credit notes: (1½)</p> <ul style="list-style-type: none"> * Donny Lopez has access to the masterfile amendment module and initiates orders and can extend credit. (1½) * No sequenced masterfile amendment form is made out, checked and authorised, to support the approved credit applications. (1½) * The log of masterfile amendments is not reviewed and tied back to supporting documentation by an independent person. (1½) 	<ul style="list-style-type: none"> - As Donny Lopez has access to debtors masterfile, he is able to "create" new debtors accounts which: <ul style="list-style-type: none"> * have not been subjected to any creditworthiness controls or been “approved” by Gene Kelly. (1½) * These “debtors” could be completely fictitious e.g. to obtain free tyres for himself or a friend. Once tyres have been obtained, he could simply pass a credit note to reduce the amount owing in the masterfile to nil. (1½) - As the MAF’s are not checked and approved by an independent person: <ul style="list-style-type: none"> * inaccurate and incomplete details may be captured resulting in problems later in the cycle e.g. invoices incorrectly addressed. (1½) * Gene Kelly can easily initiate the addition of fictitious or non-creditworthy debtors to the masterfile. (1½) - As the log is not tied back to sequenced MAF’s it is not possible to establish: <ul style="list-style-type: none"> * whether all amendments have been made accurately. (1½) * only authorised amendments have been made. (1½) * all approved amendments have been entered. (1½)

Comments:

This question asked you to identify and explain weaknesses in the revenue and receipts cycle.

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 provides an explanation of why the activity is identified as a 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. If you understand the “how and why” of internal controls you should not have a problem identifying where the weaknesses are.

Topic 5 Acquisitions and Payments Cycle

Feedback on supplementary *Do* questions on Topic 5

QUESTION 10.4 IN GRADED QUESTIONS

12 marks

Reference: Jackson & Stent (2016:8/7, 8/26)

General and application controls in the acquisitions and payments cycle:

1. Application control (1)
2. General control (1)
3. Application control (1)
4. General control (1)
5. Application control (1)
6. General control (1)
7. General control (1)
8. Application control (1)
9. General control (1)
10. Application control (1)
11. Application control (1)
12. Application control (1)

Comments:

The internal controls are from the acquisitions and payments cycle (Topic 5), but without the foundation laid in Topic 2, you would not have been able to answer this question. It is important to realise that the topics of this module should not be viewed in isolation. Most of the principles in Topic 2 and 3 are applied in each of the business cycles.

QUESTION 10.12 IN GRADED QUESTIONS

45 marks

Reference: Jackson & Stent (2016:11/9 - 11/13)

Weaknesses and explanations in the payments function:

Weakness 1

There is a lack of division of duties between the **initiation** of the order and its **execution**. (1½)

Explanation 1

- 1.1. The buying officers decide what to order without the authority of a signed requisition from the warehouse **and** they place the order. (1½) OR
- 1.2. This means that a buying officer can place an order fraudulently (e.g. order goods for himself). (1½)

Weakness 2

There is no sound basis for the placing of orders e.g. no reorder level or quantity, no sales projection data, etc. (1½)

Explanation 2

- 2.1. When deciding what inventory to purchase, the buyers simply look at the quantity on hand on the perpetual inventory. There is no guidance on which to base the quantity of toys to be ordered or whether a particular toy should be ordered at all. (1½) OR
- 2.2. This is inefficient management of the company's resources i.e. tying up funds in excess inventory and potential loss from redundant/obsolete inventory. (1½) OR
- 2.3. It may also lead to failure to order enough inventory, resulting in lost sales. (1½) OR
- 2.4. As there is no reconciliation between physical inventory on hand and the masterfile there may be no physical inventory and a quantity reflected in the masterfile. Hence no order may be placed when an order is necessary. (1½)

Weakness 3

Orders placed are not authorised by the senior buyer Goliath Booyesen. (1½) OR

Additions to the preferred supplier masterfile are not authorised by Goliath Booyesen. (1½)

Explanation 3

As Goliath Booyesen does not see the orders before they are sent, there is no check that they are for goods for the company, from an approved supplier. This, combined with weakness 2 makes it even easier for an employee to place an invalid order. (1½)

Weakness 4

Access to the local area network at systems level is inadequate. (1½)

Explanation 4

The use of a general password to get onto the network amounts (almost) to uncontrolled access. This weakness at systems level weakens access to applications on the network, in this case acquisitions and payments. (1½)

Weakness 5

Access at application level is inadequate which severely weakens (failure to apply need to know/minimum entry principle) division of duties and isolation of responsibility. (1½)

Explanation 5

- 5.1 All employees in the “ordering” and “receiving” functions of the acquisition cycle have access to all the modules in the application by virtue of a common password. (1½) OR
- 5.2 In effect, this means that at least nine employees are able to initiate an order; place an order; effect a masterfile amendment e.g. add a supplier **and** in the case of the receiving clerks; and gain easy access to the goods ordered **and** amend the records. (1½) OR
- 5.3 The above substantially increases the risk of invalid purchase transactions occurring. For example, a receiving clerk could easily place an order for goods for himself, receive the goods, steal them, amend the inventory records if necessary, and have the company pay for the goods. (1½)

Weakness 6

Poor programming/application design results in the need for employees to enter extensive information which is already in the database (failure to apply minimum entry principle). (1½)

Explanation 6

When creating a purchase order, although the format comes up on the screen, the buyer must still enter all the details pertaining to the supplier and the goods to be ordered. In principal the **minimum** amount of information e.g. quantity and product number should have to be entered. Information already on the database should automatically be included. This enhances the accuracy and completeness of the order being placed as fewer keying in errors will be made e.g. incorrect descriptions, product numbers, etc. (1½)

Weakness 7

The receiving clerk checks what has been delivered against the supplier delivery note **only**, not against the purchase order. (1½)

Explanation 7

- 7.1 Adjusting the supplier delivery note for discrepancies between the goods delivered and the supplier delivery note **but not** for discrepancies with the purchase order will result in the company accepting (and ultimately paying for) goods in excess of what they ordered or which they did not order at all. (1½) OR
- 7.2 As the inventory masterfile is updated by what was actually received and the “pending order field” is cleared, the buyer will not know if there has been an over-or-under supply of what he actually ordered. (1½) OR

7.3 Short deliveries will not be addressed as no comparison is made between what was actually ordered and received. (1½)

Weakness 8

There is no checking or acknowledgement of receipt of the goods when they are moved from the “receiving department” to the warehouse (poor isolation of responsibilities). (1½)

Explanation 8

As the boxes are placed in the cage to be dealt with by warehouse staff when they have time, there is a period when nobody has responsibility for the goods; if discrepancies are discovered the goods receiving clerks can simply say they put the goods in the cage and the warehouse staff can say the goods were not put in the cage, i.e. the goods were not in their custody. (1½)

Weakness 9

Nobody counts/checks the contents of boxes for quantities and goods actually delivered and nobody checks for damaged goods. The receiving clerk checks only to the details on the side of the box. When the toys are unpacked from the boxes in which they are delivered, the warehouse packers do not check what has actually been received against any documentation before the goods are packed away on the shelves. (1½)

Explanation 9

As Toy-Toy (Pty) Ltd does not know exactly what toys they actually received they will in all likelihood be paying for goods they never received/are damaged and have very poor inventory records which will result in losses through inefficient inventory management. (1½)

Weakness 10

10.1 As in weakness 6, poor application/programme design results in the receiving clerk having to enter data that is already on the system when they create the goods received note. (1½)
OR

10.2 The receiving clerk has complete control over the information that is entered onto the system as he does not simply update **authorised** information already on the system **and** nobody checks that the details on the GRN agree with the supplier delivery note. (1½)

Explanation 10

10.1 Again the less information that has to be entered, the fewer errors of **accuracy** and **completeness** will arise. This will result in fewer problems in the functions which flow from the GRN e.g. inventory record maintenance and payment to creditors. (1½) OR

10.2 In respect of weakness 9, significant fraud is possible by the simple entry of fictitious (invalid) information, e.g. the receiving clerk can make out a completely (or partially) fictitious GRN, arrange for a fictitious invoice/statement to be sent to Toy-Toy (Pty) Ltd by a fictitious supplier and then share the ensuing payment to the supplier. Making this type of fraud even easier, is the lack of access controls and division of duties as explained in weakness 5. (1½)

Weakness 11

Controls of masterfile amendments are inadequate. (1½)

Explanation 11

At least nine employees have access to the masterfile amendment module of this application; Goliath Booysen does not authorise additions of suppliers; there does not appear to be any documentation (MAF) to support amendments; and there is no review of logs of masterfile amendments for accuracy, completeness and validity by an **independent** manager, any number of employees could make invalid amendments to facilitate fraud. (1½)

Weakness 12

The lack of supervisory and managerial controls results in a poor control environment. (1½)

Explanation 12

As neither Goliath Booysen nor any other members of the management get involved in the activities described, employees will before long realise that they can do precisely as they please, including engage in fraudulent activities for their own benefit. (1½)

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.

This question asked you to identify and explain weaknesses in the acquisitions and payments cycle.

The solution covers all weaknesses identified for each of the relevant phases (e.g. Processing of orders) in the payments and acquisitions cycle and then provides an explanation of why the activity is identified as a 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. If you understand the “how and why” of internal controls you should not have a problem identifying where the weaknesses are.

QUESTION 10.15 Part A (c, d) IN GRADED QUESTIONS

24 marks

Reference: Jackson & Stent (2016:8/16 - 8/22 and 11/16 - 11/18)

(c) Application controls for online approval of purchase orders

10.5 marks

1. Once the order clerk has compiled the file of purchase orders it will be available on the system to be accessed by Polly Clarkson for approval. On completion of the file the order clerk will select, say, the “approval requested” option and a message will appear on Polly Clarkson’s screen alerting her that the file is ready. (1½)
2. The approval function will be linked to Polly Clarkson’s user profile. The order clerk will not have approval privileges, e.g. his screen will either have no “visible” approve option for him to select or the option will be shaded and will not respond if clicked on. (1½)

3. Polly Clarkson will access the file (read only) and check each order against supporting documentation e.g. purchase requisitions. (The supporting documentation may be “physical” or on the system) to the extent she considers necessary. (1½)
4. Polly Clarkson will access the file (read only) and confirm that there is an order for all items on the purchase requisition report and that no additional items were ordered. (1½)
5. Polly Clarkson will not have write access to the purchase order file and any changes she might require will have to be made by the order clerk; the file will be “transferred” back to him and the necessary changes communicated to him. Once the changes have been made, the approval process is repeated. (1½)
6. Once the purchase order file has been approved by Polly Clarkson, no changes can be made to it by the order clerk. (1½)
7. Again, once the approval option is selected by Polly Clarkson, a message will be sent to the order clerk (on screen). He will then execute the order by phone, email or fax. (1½)

(d) Internal controls for valid additions to the creditors masterfile

13.5 marks

1. All additions of suppliers are recorded on pre-printed, sequenced masterfile amended forms (MAF). (1½)
2. A comprehensive evaluation of the supplier, e.g. reliability, pricing and quality of goods is conducted by senior personnel, including Polly Clarkson, before the supplier is approved. (1½)
3. Independent confirmation of the suppliers banking details is obtained. (1½)
4. The MAF is cross-referenced to supporting documentation and authorised (signed) by Polly Clarkson and a second senior employee. (1½)
5. Logical access to the masterfile amendment module is restricted to a limited number of personnel by the use of user Id's, user profiles and passwords. (1½) (possibly a single terminal on the network (by the use of terminal profiles))
6. All masterfile amendments are automatically logged by the computer on sequentially numbered logs, i.e. date, time, terminal, user ID, sequential MAF number and amendment details. (1½)
7. Only “read only” access to the logs is given (see 8 below). (1½)
8. Logs are frequently and regularly reviewed by an independent senior employee who must confirm that all logged amendments are supported by authorized MAFs. (1½)
9. Unused MAFs are subject to strict stationery controls. (1½)

Comments:

Masterfiles contain semi-permanent and permanent information. It is therefore of the utmost importance that access and changes to the masterfile be strictly controlled.

For question (d), the control objective was provided. Keep in mind that questions may limit you to specific control objectives, like in this case. You may also be limited to specific business cycles or functions within a cycle.

Topic 6 Inventory and Production Cycle

Feedback on supplementary *Do* questions on Topic 6

QUESTION 11.1 IN GRADED QUESTIONS

12 marks

References: Jackson & Stent (2016:12/4 - 12/5)

Explanation of documents used in the cycle

1. **Goods received note:** When goods are received from a supplier, the receiving clerk will make out a sequenced goods received note (computerised or manual) which records the details of the goods received from the supplier. This is a document used in the acquisitions cycle but is also the document which records the “arrival” of goods into the inventory and production cycle. (1½)
2. **Production schedules:** These documents are used to notify the production/manufacturing department as to what is required to be produced. What is to be produced will be decided by an analysis of future sales (forecasts), current stockholdings of finished goods and specific orders or contracts which have been obtained. The analysis will be committed to a production plan. (1½)
3. **Materials issue note:** These documents authorise the removal (transfer) of items from stores to production. (1½)
4. **Inventory sheets:** A document which is used during an inventory count. The inventory sheet will usually contain the description of the inventory items, their location in the stores, and a column into which the quantity of inventory actually counted, can be entered. The document will usually also contain a column for entering the cost of the item and a column into which the extension of quantity x price can be entered. (1½)
5. **Inventory adjustment form:** The inventory adjustment form is a sequenced document which is used to record adjustments which must be made to correct the perpetual inventory records when actual inventory and theoretical inventory (per the perpetual inventory records) do not agree. The inventory adjustment form will be authorised (after the difference has been investigated) and will be the supporting document for the adjustment. (1½)

6. **Job cards:** A job card is a document which travels through the stages of production with a specific job. As costs are accumulated, e.g. raw materials used or, labour hours expended, they are recorded on the job card. At a later stage, an overhead allocation can be made to arrive at the total cost of production for the job. (1½)
7. **Inventory tag:** An inventory tag is a small, numerically sequenced, cardboard tag, which is attached to the different types of inventory before an inventory count. It will be in two distinct, but identical parts which will contain a tag sequence number, the inventory number and description, and an empty block into which the quantity of inventory on hand will be entered as the inventory item is counted. When the first counting team has counted the number of items for that particular inventory item, they will enter the number in the quantity block of one part of the inventory tag. They will then remove that part of the tag and hand it to the count controller. The second count team will perform a second count and follow the same procedure. The count controller will match the two parts of the inventory tag and any discrepancies will be recounted. This results in an accurate inventory count. (1½)
8. **Transfer to finished goods note:** This document records the transfer of manufactured goods from the production department into the finished goods stores. (1½)

Comments:

You need to know the specific documents used in each cycle, as each document is specific for each function on each cycle. Remember, "post-its" are also documents, but obviously not acceptable as an internal control document. Therefore, make sure you know your documents. If it is not documented, there is no audit trail and no proof that transactions occurred.

QUESTION NUMBER 11.5 IN GRADED QUESTIONS

20 marks

References: Jackson & Stent (2016: 8/7, 8/26)

General and application controls in the inventory and production cycle:

General IT control OR Application control	Objective of control
1. General control (1)	Implemented to assist in preventing theft of inventory. (1)
2. Application control (1)	Implemented to provide a division of duties between custody of the inventory and record keeping for inventory. (1)
3. Application control (1)	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. (1)
4. Application control (1)	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. (1)

5. General control (1)	implemented to improve the control environment at Soundwaves (Pty) Ltd. Reflects management's commitment to the competence of staff and a positive and proactive philosophy and operating style. (1)
6. General control (1)	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. (1)
7. General control (1)	Implemented to enhance the control environment by the enforcement of integrity and ethical values. (1)
8. Application control (1)	Implemented to prevent unauthorised amendments to the inventory records being made (primarily) to conceal theft of inventory. (1)

Comments:

The internal controls are from the inventory and production cycle (Topic 6), but without the foundation laid in Topic 2, you would not have been able to answer this question. It is important to realise that the topics of this module should not be viewed in isolation. Most of the principles in Topic 2 and 3 are applied in each of the business cycles.

QUESTION NUMBER 11.8 (b) IN GRADED QUESTIONS**20 marks**

References: Jackson & Stent (2016:5/7 - 5/17 & 12/6 - 12/10)

Weaknesses and recommendations (internal controls) in the production cycle**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 counts 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 deal 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**33 marks**

Reference: Jackson & Stent (2016:13/4 - 13/5, 13/9 - 13/13)

(a & b) Function and risk in the payroll cycle**30 marks**

Function	Risk
1. Personnel	
1.1 Assisting with all personnel matters e.g. counselling, training and wage negotiation. (1)	1.1 Engaging unsuitable staff, e.g. underqualified, not competent or unethical. (1)
1.2 Acting as an independent keeper of records pertaining to personnel. (1)	1.2 Failing to comply with legislation e.g. illegal dismissal of workers. (1)
1.3 Facilitating the lawful recruitment and dismissal of personnel. (1)	1.3 Failing to prevent unauthorised changes to employee records such as fictitious additions, changes to salary grades, etc(1)
	1.4 A dissatisfied workforce arising from the implementation of unsound human

	resource policies and practices which could lead to strikes, go-slows or worse.(1)
2. Timekeeping 2.1 Creating an accurate record of the hours for which employees must be remunerated, both normal and overtime hours. (1) 2.2 Calculating total hours worked for the week. (1)	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.*card being clocked for a fictitious employee or *employee clocking or “swiping” another employee’s clock card or magnetic identification tag when that employee is absent(1) 2.2 Miscalculating normal hours and overtime hours (including the split between the two). (1)
Payroll preparation 3.1 Calculating amounts payable in respect of genuine hours (gross). (1) 3.2 Determining deductions from gross pay. (1) 3.3 Creating the payroll reflecting net pay. (1) 3.4 Prepare coinage schedule. (1)	3.1 Addition of fictitious employees to the payroll. (1) 3.2 Use of incorrect/unauthorised payrates, hours or deduction tables which will result in the incorrect amount being paid. (1) 3.3 Cast and calculation errors. (1)
Payment preparation and payment 4.1 Place cash in the pay-pocket and provide a record of how amount is made up. (1) 4.2 Paying out of wages - Transfer wages to employees or Obtaining evidence that wages have been received. (1) 4.3 Initiate control over unclaimed wages. (1)	4.1 Errors or theft of cash during drawing of cash, making up of pay-packets and at the pay-out. (1) 4.2 Misappropriation of unclaimed wages. (1) 4.3 Wage packet not given to the correct employee. (1)
5. Deductions: payment and recording 5.1 Record amounts owed to other bodies in respect of amounts deducted e.g. PAYE, and(1) 5.2 Completion of supporting documentation (return) and payment of these liabilities to the relevant authorities timeously. (1)	5.1 Incurring penalties for the non-payment, late payment or underpayment of amounts owed. (1) 5.2 Criminal/civil charges due to non-payment. (1) 5.3 Inaccurate amounts paid over. (1) 5.4 Supporting (documents) returns incorrectly completed and rejected by recipient. (1)

(c) Change in the functions when computerised**3 marks**

The functions would not change if Goingup (Pty) Ltd computerised its payroll cycle. (1) Certainly how each function is carried out will change, for example, the preparation of the payroll will be carried out on the system (payout would be by EFT). (1) However, there will still be a human resource section, computerised timekeeping, etc. (1)

QUESTION 9.8 IN GRADED QUESTIONS**14 marks**

Reference: Jackson & Stent (2016:13/9 - 13/13, 8/32 - 8/38)

1. Deepdiggers Ltd: Risks in the payroll and personnel cycle**6 marks**

1. Loss of production from strike action (1)
2. IT risk. An IT “disaster” which directly affects the processing and payment of wages accurately and timeously (1)
3. Health risks which threaten the wellbeing and efficiency of the workforce (1)
4. Outbreaks in xenophobia leading to violence, death and injury to the workforce. (1)
5. Lack of trained and skilled mining personnel (1)
6. Failure to comply with black economic empowerment and employment equity laws and regulations (1)

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, for example, weaknesses or risks or internal controls.

In this question, you had to provide risks identified in the work force of Deepdiggers Ltd – thus risks in the payroll and personnel cycle.

Did you notice that the risks identified was not a memory dump? It was specific to the scenario provided. Even though the textbook provides a large volume of risks and internal controls, it is not comprehensive. However, it does teach you how to identify risks and determine appropriate internal controls.

4. Bingo (Pty) Ltd: Automated controls**8 marks**

1. **Screen formatting:** Screen designed to facilitate accurate and complete entry. (1)
2. **Minimum entry:** Wage clerk only required to enter employee number to bring up other details of employee. (1)
3. **Validation check:** System will compare employee number entered to employee masterfile. If there is no match, wage clerk cannot continue. (1)
4. **Alphanumeric check:** Example, entry of an alphanumeric character in the hours worked field will be rejected. (1)

5. **Limit check:** Example, normal hours entered in excess of 40 hours will be rejected. (1)
6. **Mandatory field:** Process will not continue if normal hours field is not entered. (1)
7. **Batch control totals:** The entry of batch control totals prior to keying in, and the comparison by the system of these control totals after keying in, will identify inaccurate or incomplete entry. (1)
8. **Access control:** Restricting access to the “enter hours module” to the wage clerk will contribute in a general sense to control in this function. (1)

Comments:

These automated controls are applied in the payroll and personnel cycle. However, automated controls are applicable in all cycles. As previously mentioned, it is important to realise that the topics of this module should not be viewed in isolation. Most of the principles in Topic 2 and 3 are applied in each of the business cycles.

QUESTION 9.12 (c, d) IN GRADED QUESTIONS

30 marks

Reference: Jackson & Stent (2016: 13/9 – 13/13, 13/24/ - 13/27)

(c) Employees’ banking details on the employee masterfile are valid, accurate and complete **10 marks**

1. Any employee needing to change his banking details should be required to provide details of the change in writing on an internal pre-printed standard form, which must be stamped by the bank (or accompanied by a letter from the bank) (validity). (1½)
2. All bank detail amendments should be entered onto pre-printed sequenced masterfile amendment forms and cross-referenced to the instructions from the employee (validity, accuracy and completeness). (1½)
3. The MAFs should be signed (authorised) by Nate Frisk and Sias Reyneke after scrutiny by both parties of the relevant documents (validity). (1½)
4. The responsibility for entering the MAFs onto the system should be allocated to a specific employee in human resources (confidentiality and validity). (1½)
5. Logical access controls should include the use of user ID’s and passwords and user profiles should be constructed on a least privilege/need to know basis, e.g. only the designated employee has write access to the salaries masterfile amendment module or read access is given only to Nate Frisk, Sias Reyneke, Morgan Govind and possibly senior divisional personnel (validity). (1½)
6. Write access to the salaries application *could be* restricted to terminals in human resources. Masterfile amendments should be automatically sequence checked by the computer and recorded on sequentially numbered logs. (validity and completeness). (1½)
7. Access to the *logs* should be read only and restricted to Morgan Govind and Sias Reyneke (validity). (1½)

8. Morgan Govind should review the log to ensure that each masterfile amendment logged, is supported by a properly supported MAF (and supporting bank stamped documents); ensure the sequence of logs is intact; and the sequence of MAF's is intact. (validity, accuracy and completeness) (1½)
9. To enhance the accuracy and validity of input, there should be programme controls, e.g. minimum entry (employee number brings up employee detail), validation check (valid employee number) and/or missing data/mandatory field e.g. branch code of bank. (1½)
(1½ for each valid comment to a maximum of 10 marks)

(d) Controls which should be carried out with regard to the payment of salaries from the point where Morgan Govind approves the payroll on the system 20 marks

1. Two of the three employees issued with random number generators will be required to effect the transfer. For the purposes of this example, we will assume that Mary Topper will *authorise* the payment and Nate Frisk will *release* the payment. (1½)
2. Once Morgan Govind has approved the payroll file on the system it should not be possible to write to the file. (1½)
3. The bank's EFT software should only be loaded on the terminals of say, Mary Topper, Sias Reyneke and Nate Frisk. (1½)
4. To access the bank's site the two authorizing employees will enter their user IDs and password. (1½)
5. To access the function which enables them to make an EFT payment they will be required to enter a unique PIN number issued by the bank when they were "registered" with the bank to be able to make EFT payments. (1½)
6. All user IDs, PINs and passwords should be linked to the individual employee's user profile. (1½)
7. There should be automatic shutdown after three unsuccessful attempts to access the company's bank account (and an SMS may be sent to Mary Topper). Unauthorised attempts to access should be logged and followed up. (1½)
8. The data should be encrypted. (1½)
9. Conventional password controls should apply, and the random number generators should be kept safely and securely. (1½)
10. When Morgan Govind selects the "approve" icon, a system generated message will be sent to say Mary Topper's terminal alerting her to the fact that the payroll is awaiting her approval. (1½)
11. Mary Topper will access the file and carry out whatever checks she deems necessary e.g. she should verify masterfile amendments particularly changes in banking details and the addition of new employees to source documentation. Mary Topper will not have write access and any changes will need to be referred back to Morgan Govind. (1½)

12. If satisfied with the file, Mary Topper will select the “first confirmation” option and the file will be transferred to Nate Frisk. (1½)
13. Nate Frisk will conduct whatever tests he wishes to (generally of a review nature) to be in a position to “authorize” the payroll. To do so he will select the “second confirmation” option. (1½)
 - *the second confirmation cannot be activated before the first confirmation and Nate Frisk will not have write access.
14. Once the “second confirmation” has been selected the file will be fully approved and will be automatically converted to a format compatible with the bank’s software. (1½)
15. Once this has been done, Mary Topper will click on the “authorize” option and will be requested to enter the “one time password” she will obtain by activating the random number generator. (1½)
16. Nate Frisk will then click on the “release” option and will be requested to insert his “one time password”. (1½)
 - *the release option cannot be activated before the authorize option.
17. Within a day or two of making the EFT Morgan Govind should download a copy of the bank statement and reconcile it to the payroll file. (1½)
18. Controls to protect against invalid EFTs may also include
 - * arranging with the bank that salary payments take place only on specified dates (1½)
 - * the transfer of the total amount of salaries to be paid to a 2nd bank account specifically for salary EFTs. This protects the main bank account and enhances confidentiality (1½)
 - * agreeing limits with the bank on amounts which can be transferred by EFT within a stipulated period or to a single account from the salary account. (1½)

(1½ for each valid comment to a maximum of 20 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? For example, weaknesses or risks or internal controls.

In this question, you had to provide controls relating to the payroll and preparation cycle specifically related to the changes in banking details and the payment of employees.

Did you notice that the controls identified was not a memory dump? It was specific to the scenario provided. Even though the textbook provides a large volume of risks and internal controls, it is not comprehensive. However, it does teach you how to identify risks and determine appropriate internal controls.

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 (2016:5/5 - 5/17 & 14/2 - 14/5)

Weaknesses and recommendations (internal controls) in the finance and investment cycle

WEAKNESSES	RECOMMENDATIONS
<p>1. The acquisition (investment in) fixed assets is not planned. (1½)</p> <ul style="list-style-type: none"> There is no evaluation of whether the items purchased by the five sectional accountants are required. (1½) Any member of the section can request equipment without providing proper motivation. (1½) 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) It also provides an opportunity for misappropriation of equipment by employees. (1½) 	<ul style="list-style-type: none"> The company should appoint a fixed asset committee consisting of senior experienced management which will be responsible for <ul style="list-style-type: none"> evaluating the need for the purchase of capital expenditure. (1½) evaluating how capital expenditure will be financed. (1½) All requests for fixed assets from sections and individuals within a section must be fully motivated. (1½) The fixed asset committee should be responsible for preparing an annual capital expenditure budget (see below). (1½)
<p>2. The budgeting process is totally ineffective. (1½)</p> <ul style="list-style-type: none"> Simply increasing the prior year's budget by an index has resulted in sections being allocated money which they do not require and which will be wasted. (1½) This weakness is compounded by the fact that sections are "punished" for not spending their allocation by having their budgets reduced. (1½) 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) 	<ul style="list-style-type: none"> Proper budgeting for capital expenditure system should be put in place(1½) <ul style="list-style-type: none"> 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) The sectional budgets should be submitted to the fixed asset committee for their approval, which should only be given after careful consideration of <ul style="list-style-type: none"> the motivation for the expenditure(1½) alternatives the overall budget for the business and other sections(1½) company cash flows(1½) Should an item which appears in the budget not be required, it should not be

WEAKNESSES	RECOMMENDATIONS
	<p>purchased. (1½)</p> <ul style="list-style-type: none"> There should be ongoing comparison of actual capital expenditure to budgeted expenditure. (1½)
<p>3. There is inadequate authorisation of capital expenditure. (1½)</p> <ul style="list-style-type: none"> Sectional accountants have complete authority to purchase equipment, provided they have not exceeded the budget. (1½) 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) In effect, the sectional accountants can make a purchase and authorise it, which is a lack of division of duties. (1½) 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) 	<ul style="list-style-type: none"> The fixed asset committee should approve the budget, which will then become the fundamental authorising document. (1½) See points below (4)
<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"> No properly designed, pre-printed, sequenced (and authorised) requisition form is presented to support the purchase request (e-mail is sent). (1½) The order is placed by the assistant to the sectional accountant (not the buying department) without any follow up with the supplier as to availability and price and alternative suppliers. (1½) 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. 	<ul style="list-style-type: none"> 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) This requisition should be submitted to the sectional accountant who should authorise the requisition (sign) after confirming that the request complies with the capital expenditure budget. (1½) A copy of the requisition should be sent to the company buying department, and the second copy filed in numerical sequence. (1½) The order department should: <ul style="list-style-type: none"> ➤ confirm that the goods requisitioned appear on the capital budget and if so (1½) ➤ check with the preferred supplier as

WEAKNESSES	RECOMMENDATIONS
<p>(1½)</p> <ul style="list-style-type: none"> Items purchased should not be delivered to the individual sections as this weakens division of duties. (1½) 	<p>availability, current price, delivery particulars, etc, and (1½)</p> <ul style="list-style-type: none"> ➤ make out and sign a three part pre-printed, sequenced (capital expenditure) order (1½) <ul style="list-style-type: none"> ✓ Copy 1 – to the supplier (1½) ✓ Copy 2 – to goods receiving department (1½) ✓ Copy 3 – to accounting (1½) 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"> ➤ Copy 1 – sent with the items to the section (with copy 3 as well) (1½) ➤ Copy 2 – sent with supplier delivery note to accounting (1½) ➤ Copy 3 – filed in receiving (1½)
<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"> Places the order (on the strength of an e-mail) (1½) receives the goods (1½) <ul style="list-style-type: none"> "authorises" payment (by sending the unchecked documentation to creditors) (1½) writes up the records (fixed asset register) (1½) <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"> The controls suggested above will also address this weakness. 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) 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)

(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.

Insight Education website questions on the business cycles

Topic 4 Revenue and Receipts Cycle

Feedback on supplementary Insight Education questions on topic 4

QUESTION 1

6 marks

Reference: Insight Education Sales Video (Time: 12:21)

Information that should be on pre-numbered internal compiled invoice:

1. Reflect the value of the sales as calculated from the authorised price list at the time the order was placed. (1½)
2. It should be based on the actual quantity of goods received by the client as indicated on the delivery note. (1½)
3. It should take into consideration any returns. (1½)
4. Give reference to the original sales order as well as all of the company’s details. (1½)

QUESTION 2

3 marks

Reference: Insight Education Cash Cycle (Time: 1:15)

The Cash Cycle (1½) because the company cannot restrict access to the store, as it is open to all members of the public. (1½)

Topic 5 Acquisitions and Payments Cycle

Feedback on supplementary Insight Education questions on topic 5

QUESTION 1

6 marks

Reference: Insight Education Purchasing Cycle (Time 2:21)

Activities of the ordering manager when receiving an order:

The ordering manager should verify all the information on the order form (1½) against the authorised inventory requisition (1½) and the authorised suppliers list (1½) and finally sign off if he or she is satisfied with the purchase order (1½).

Topic 6 Inventory and Production Cycle

Feedback on supplementary Insight Education questions on topic 6

QUESTION 1

9 marks

Reference: Insight Education Production Cycle (Time: 14:08)

Principles (internal controls) demonstrated in the production cycle:

1. All activities should be accompanied by supporting documents. (1½)
2. There should always be monitoring by a person in authority. (1½)
3. Quality, quantity and description evaluations should always be performed. (1½)
4. All stationary and physical goods should be physically secured. (1½)
5. There should always be a follow-up process. (1½)
6. The process should be accounted for in the general ledger. (1½)

Topic 7 Payroll and Personnel Cycle

Feedback on supplementary Insight Education questions on topic 7

QUESTION 1

4½ marks

Reference: Insight Education Salaries and Wages Cycle (Time: 1:00)

Three stages in the payroll and personnel cycle:

1. Human Resource (1½)
2. The process for wage workers (1½)
3. The payment process for salaried workers (1½)

Concluding remarks

We hope that your understanding of the topics has improved after working through these questions and that you are now better equipped for the examination. The questions tests your knowledge of the various topics, therefore, when answering these questions, please use it as a learning opportunity.