

AUE 2602

Corporate Governance in Accountancy

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Important Information

Remember the submission of either assignment allows you entry into the exam and will be used in calculating your year mark.

Examination: **30 October 2017 08:30 – 10:30** (80%)

Important Information

myUnisa has the following resources:

- Prescribed study material
- All tutorial letters
- Past examination questions
- Discussion forums
- Additional resources
- Etc.

Make sure that you familiarize yourself with the information contained in myUnisa and MO001

Important Information

DO NOT STUDY ONLY THESE NOTES AS THEY
ARE NOT COMPREHENSIVE ENOUGH FOR YOU
TO PASS YOUR EXAMS.

IT IS MERELY TO AID YOU IN YOUR STUDIES.

Structure of Course

- Topic 1: Corporate governance and statutory matters
- Topic 2: Internal control
- Topic 3: Business cycles
- Topic 4: Revenue and receipts cycles
- Topic 5: Acquisitions and payments cycle
- Topic 6: Inventory and production cycle
- Topic 7: Payroll and personnel cycle
- Topic 8: Finance and investment cycle

Topics covered in these slides

- **Topic 1:** Corporate governance and statutory matters
- **Topic 2:** Internal control

Topic 1: Corporate governance and statutory matters

- Background to corporate governance
- Section 76 to 78 and 94 of the Companies Act
- King IV Report (Significant matters)

The aim of this topic is to **explain** and **apply** corporate governance in practical situation, by referring to the Companies Act and the King IV Report

Background to Corporate Governance

- What is meant by Corporate Governance (CG)?

It is a system whereby **organisations** are **directed and controlled**.

- Why is there a need for Corporate Governance?

As we are all **linked** to **organisations** in various ways, a balance between economic, environmental and social goals for the stakeholders of the company is needed, as this will improve the quality of modern society for all.

- Definition of Corporate Governance

The exercise of **ethical and effective leadership** by the governing body towards the achievement of governance outcomes: ethical culture, good performance, effective control and legitimacy.

Background to Corporate Governance

What is the Basis of the King IV Report

- The report adopts an “**apply and explain**” basis.
- King IV assumes that all entities already incorporate its principles, as this is in the best interest of any business. Entities are required to explain in a narrative how the practices was implemented to address the principles.

Key aspects of King IV

Sustainable development

Development that meets the needs of the present without compromising the ability of future generations to meet their needs.

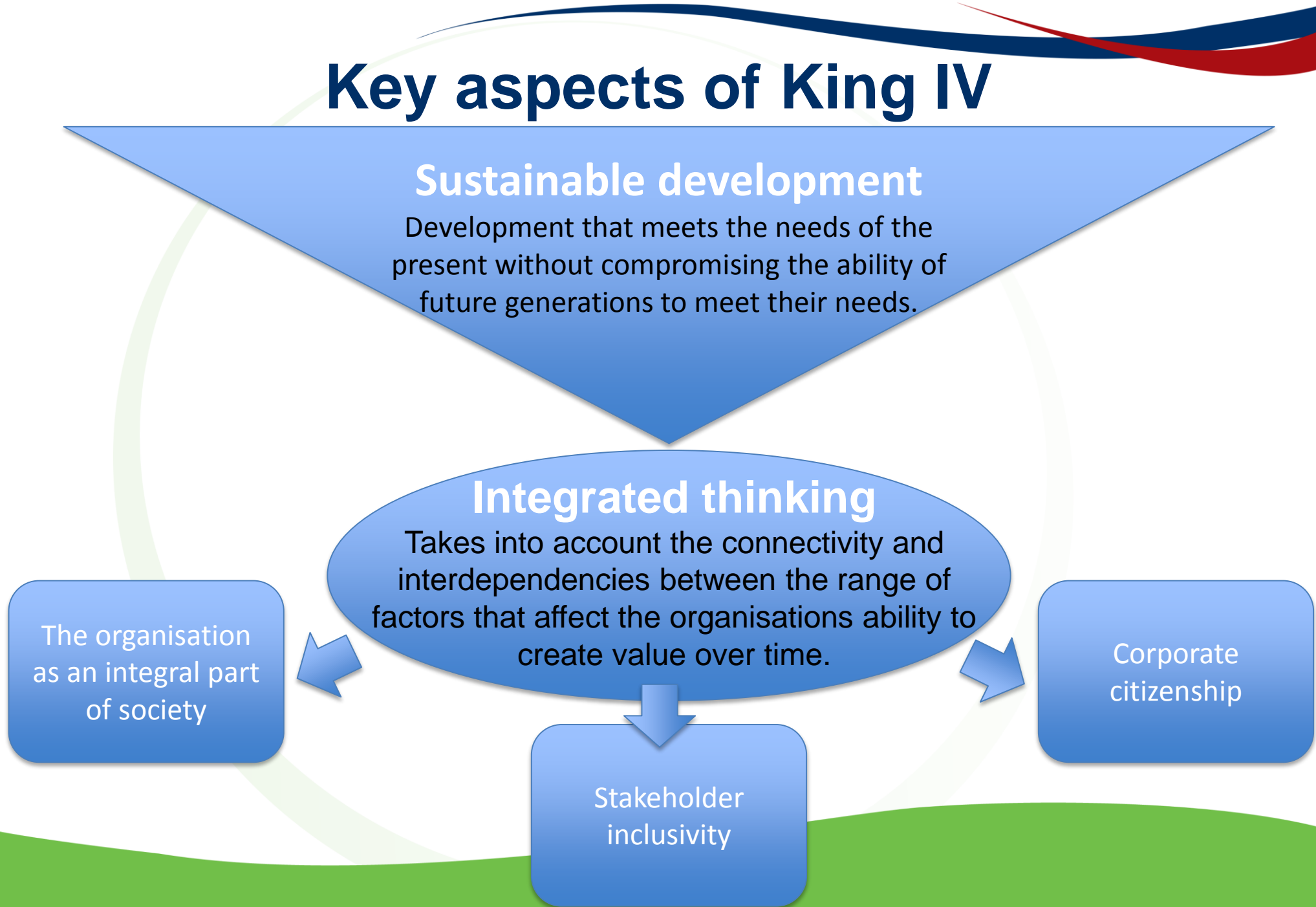
Integrated thinking

Takes into account the connectivity and interdependencies between the range of factors that affect the organisations ability to create value over time.

The organisation
as an integral part
of society

Corporate
citizenship

Stakeholder
inclusivity



Background to Corporate Governance

How has CG develop in South Africa

1. The King I Report issued in 1994
2. The King II Report issued in 2002
3. The King III Report effective in March of 2010
4. The King IV Report issued 1 November 2016, effective 1 April 2017

Note: King IV includes many of the ideas, principles and characteristics developed in King I, II and King III.

Background to Corporate Governance

Objectives of King IV

1. CG is integral to running an organisation and delivering governance outcomes e.g. ethical culture
2. Broaden acceptance of King IV – more accessible across variety of sectors and organisational types.
3. Reinforce CG as a holistic and interrelated arrangement to be understood and implemented in integrated manner.
4. Encourage transparent and meaningful reporting to stakeholders.
5. CG is concerned with structure, process, ethical consciousness and conduct.

Background to Corporate Governance

Are both King IV and the Companies Act legislated into South African Law?

The **King IV Report** is **not** legislated in South Africa. It provides **principles** and **recommendations** to all organisations in South Africa to ensure that they adhere to good corporate governance. However non-compliance to the principles of King IV is not contrary to the law.

One of the listing requirements of the JSE is compliance to the King IV Report.

The **Companies Act is legislated** into South African law, and thus if companies do not comply with the rules and laws in the Companies Act, are acting contrary to the law

Background to Corporate Governance

Study:

- The King IV Report (2016: 3-7, 20-38)
- Jackson & Stent (2016: 4/3 - 4/18)

Activities:

- Do all the activities related to this learning unit

Statutory Matters

- Always a **link** between good corporate governance and compliance with the law
- As **directors** play an important role in corporate governance, You need knowledge of the Companies Act sections which deal with directors
- These sections include: 76, 77, 78 and 94

Statutory Matters

Section 76: Standards of Directors Conduct

This section describes certain duties of directors such as:

1. Not to use the position of director

- Gain an advantage for director or any other person
- Knowingly cause harm to the company

2. Communicate to the board any information that comes to his attention

3. Exercise the powers and functions of director

- In good faith and for a proper purpose
- In the best interests of the company
- With a degree of care, skill reasonably expected of a director

Study: Companies Act S76 and Jackson & Stent (2016: 3/45 – 3/46)

Statutory Matters

Section 77: Liability of Directors and Prescribed Officers

This section deals with instances where a director and prescribed officer may be held **liable for losses** suffered by the company

- Breach of fiduciary duties
- Delict
- Acting for the company without authority
- Carrying on a business recklessly
- Etc.

Study: Companies Act S77 and Jackson & Stent (2016: 3/46 – 3/47)

Statutory Matters

Section 78: Indemnification and Directors Insurance

Any provision of an agreement, the MOI or rules or a resolution of a company, is void if it directly or indirectly seeks to relieve a director of any of that directors duties.

The section does allow certain protection of directors through indemnification (protection) and director insurance provided certain conditions are met.

Study: Companies Act S78 and Jackson & Stent (2016: 3/47-3/48)

Statutory Matters

Section 94: Audit Committees

States that a public company, state owned company or other company that is required by its MOI to have an audit committee, must elect an audit committee at each annual general meeting

- Study the membership of this committee (Members must or must not be)
- Study the duties of the audit committee

Study: Companies Act S94 and Jackson & Stent (2016: 3/53 – 3/54)

King IV Report

Applies to all entities regardless of manner and form of incorporation, however compliance is **compulsory** for **public companies listed** on the **JSE**

- The size and nature of the company will determine how the recommendations are applied

King IV Report

The **significant matters** covered by the **King Report** include:

- Leadership, ethics and corporate citizenship
- Strategy, performance and reporting
- Governance structures and delegation
- The governance of risk
- The governance of information technology
- Compliance governance
- The governance of remuneration
- Assurance
- The governance of stakeholder relationships

King IV Report

Leadership, ethics and corporate citizenship

Responsible corporate citizenship is about:

- Building sustainable businesses
- Reflecting on the role of business in society
- Doing business ethically
- Not compromising the natural environment
- Treat employees fairly
- Embracing a shared future
- Promoting an inclusive approach to governance

Study: King IV Report (2016:43-46) and Jackson & Stent (2016: 4/19 – 4/24)

King IV Report

Strategy, Performance and Reporting

- Often referred to as “triple bottom line” reporting
- Triple bottom line reporting? A company should report on its performance with regard to **economic**, **social** and **environmental** issues.
- The board should ensure the **integrity** of the company’s integrated report
- Sustainability reporting and disclosure should be integrated with the company’s financial reporting
- Sustainability reporting and disclosure should be independently assured



King IV Report

Strategy, Performance and Reporting

Study: King IV Report (2016: 47 – 48) and Jackson & Stent (2016: 4/24 – 4/26)



King IV Report

Governing Structures and Delegation

The governing body is responsible for the corporate governance of an organisation.

S66(1) of the Companies Act requires that the business and affairs of companies must be **managed** by or under the direction of a **board of directors**

King IV Report

Governing body and committees

Governing Body

Chair	Independent non-executive member
	CEO not fulfill the role of chair (CEO will not be an independent non-executive)
	The role of chair should be formalized
	The chair's performance should be assessed every alternate year
Membership	Comprise a balance of power, knowledge, skill, experience, diversity and independence
	Majority of non-executive members Majority of non-executive members should be independent
	Nominations committee to recommend the eligibility of prospective members
Members	Minimum of two executive members: one should be the CEO and the other may be the chief finance officer or other any executive as is appropriate
	Periodic, staggered rotation of members
Functions	Governing body should have a charter setting out its responsibilities, role, membership requirements and procedural conduct.
	Other functions listed under principle 6.1

King IV Report

Governing body and committees

Audit Committee

Chair	Independent non-executive member
	Chair of board should not chair audit committee
Membership	All members should be independent non-executive
Members	Minimum of three members
Meetings	Should meet with internal and external auditors at least once a year without management being present
Functions	Provide independent oversight of the effectiveness of the organisation's assurance functions and services
	Provide independent oversight of the integrity of the annual financial statements and other external reports
	May approve the annual financial statements (but the governing body remains ultimately accountable)
	The governing body may delegate the risk governance to the audit committee
	Oversee the management of financial and other risks that affect the integrity of external reports

King IV Report

Governing body and committees

Other Committees

	Remuneration Committee	Nomination Committee	Risk Committee	Social and Ethics Committee
Chair	Independent non-executive member	Not specified	Not specified	Not specified
Membership	All should be non-executive of which majority should be independent .	All should be non-executive of which majority should be independent .	Executive and non-executive of which majority should be non-executive	Executive and non-executive of which majority should be non-executive
Members	Minimum of three members	Minimum of three members	Minimum of three members	Minimum of three members

King IV Report

Governing body and committees

Other Committees continued...

	Remuneration Committee	Nomination Committee	Risk Committee	Social and Ethics Committee
Functions	Should assist the governing body in setting and administering remuneration policies.	The process for nominating, electing and appointing members of the governing body.	Should consider the risk management policy and plan and monitor the risk management process.	Oversight of, and reporting on organisational ethics, responsible citizenship, sustainable development and stakeholder relationships.
		Succession planning iro governing body members.		
		Evaluation of the performance of the governing body.		

King IV Report

Governing body and committees

- Principle 8 state that the governing body should ensure that its arrangements for delegation within its own structures promote **independent judgement**, and assist with **balance of power** and the **effective discharge of its duties**. This means that the governing body **may delegate** some of its responsibilities to various committees as needed to **ensure the best interest** of the organisations is achieved.
- The governing body **remains ultimately responsible**.

King IV Report

Governing body and committees

Study: King IV Report (2016: 49 – 60) and Jackson & Stent (2016: 4/26 – 4/40)

When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. You will notice that marks are available for **applying** the information in the scenario to the requirements of the King IV Report.

King IV Report

Non-executive member

- A non-executive member is a member who is **not involved in the management** of the company.
- The role of the non-executive member is to **provide independent judgment, advice and opinions** on issues facing the company – “an outsiders’ view”
- Required to **attend governing body and committee meetings** to which they have been appointed.

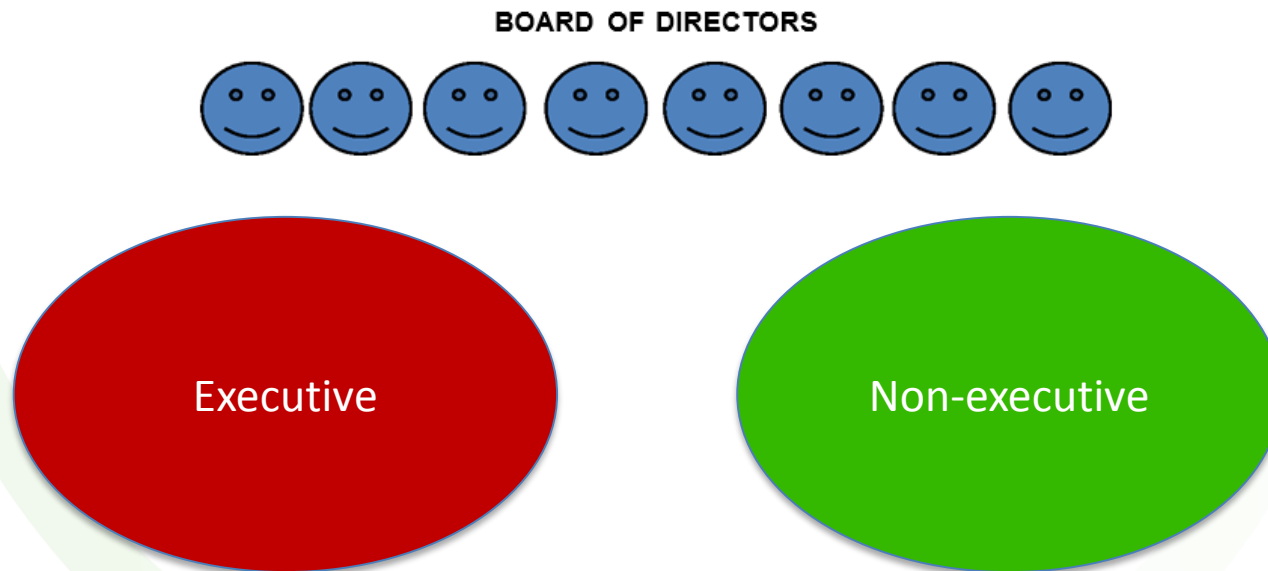
King IV Report

Independent non-executive member

- Is **not a representative of a shareholder** who has the ability to control or significantly influence management.
- Does **not have a direct or indirect interest** in the company which is material to the director or the company. (A holding of **5%** or more is considered material)
- Has not been **employed** by the company in any **executive capacity** for the preceding three financial years.
- Is not a member of the **immediate family** of an individual who is, or has been during the **previous three financial years**, employed by the company in an executive capacity.
- Is **not a professional advisor** to the company
- Is **free from any business** or other relationship which could be seen to interfere materially with the individual's capacity to act independently.
- Does **not receive remuneration contingent upon the performance** of the company.

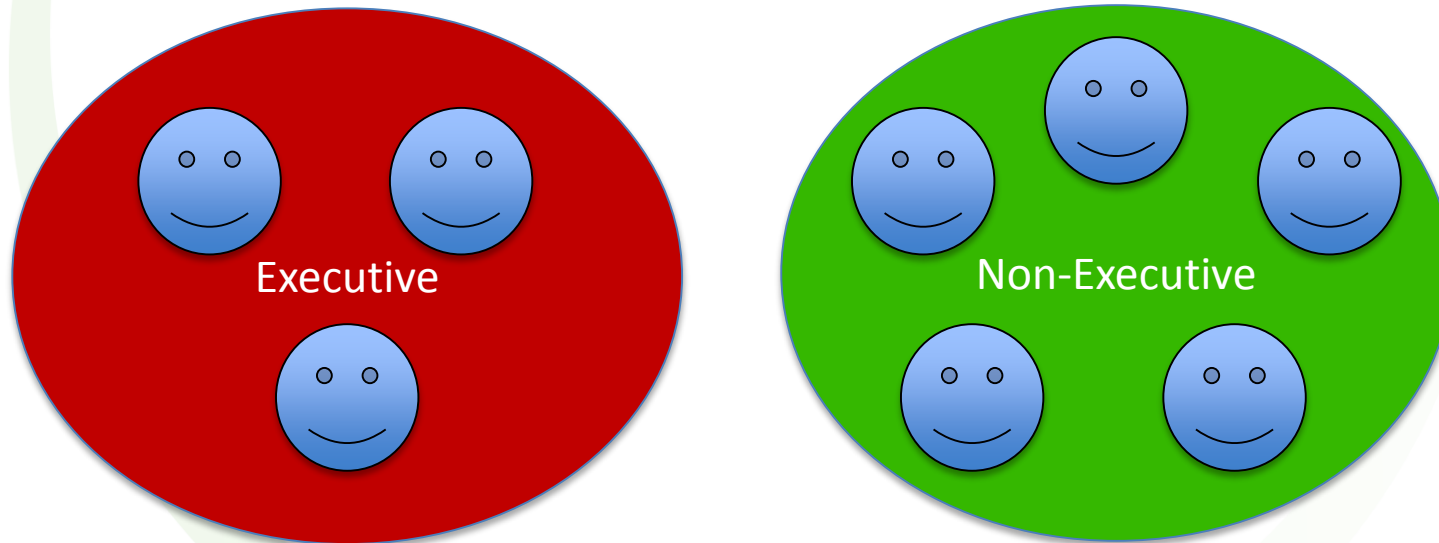
Example – Governing body composition

How should the governing body be structured in order to comply with the requirements of King IV?



Example – Governing body composition

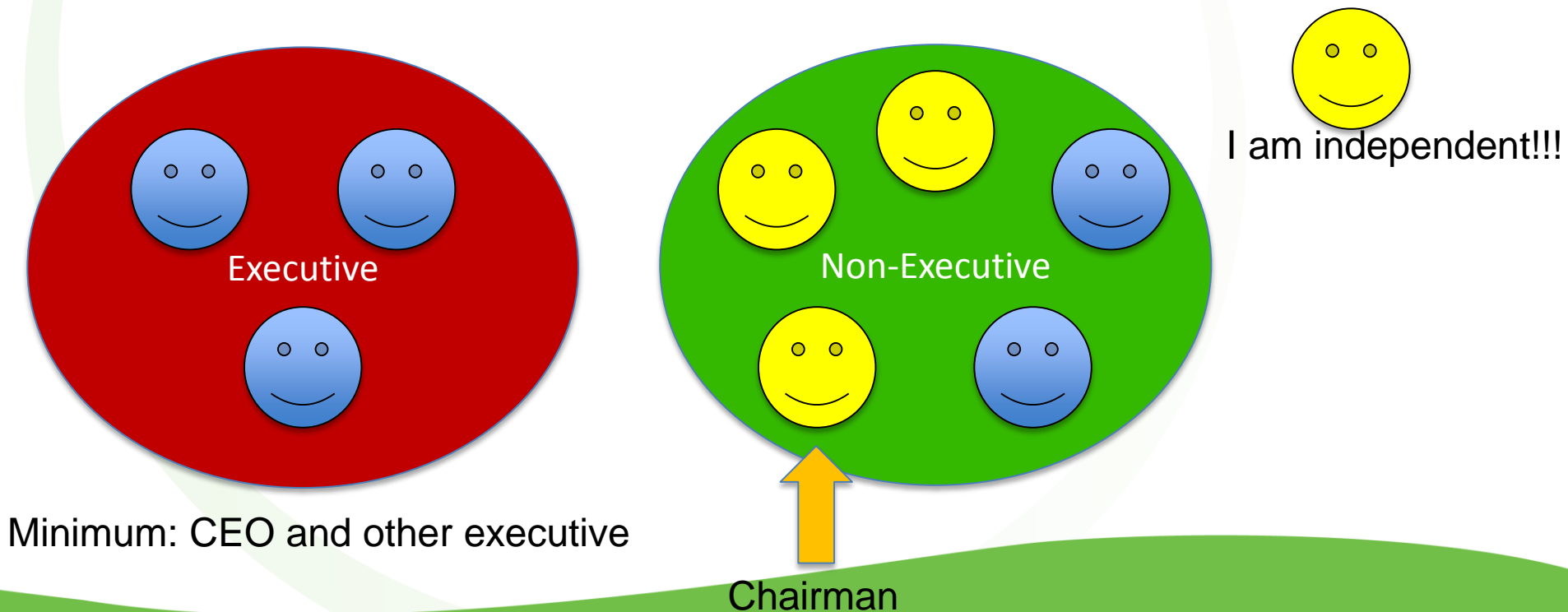
How should the governing body be structured in order to comply with the requirements of King IV?



Minimum: CEO and other executive

Example – Governing body composition

How should the governing body be structured in order to comply with the requirements of King IV?



Quick Quiz 1

Would the following individual qualify as an independent non-executive member in terms of the King IV Report? Justify your answer:

- A partner in the law firm that acts as legal advisors to the company;
- The company's external auditor;
- The company's recently retired CEO;
- A shareholder who holds 3% of the company's shares

Quick Quiz 1

Would the following individual qualify as an independent non-executive member in terms of the King IV Report? Justify your answer:

- A partner in the law firm that acts as legal advisors to the company → NO;
- The company's external auditor → NO;
- The company's recently retired CEO → NO;
- A shareholder who holds 3% of the company's shares → YES

Quick Quiz 2

State whether the following are true or false in terms of the King IV Report:

- The chair of the audit committee should be the chair of the board;
- The CEO must chair the remuneration committee;
- The nominations committee should consist of only non-executive directors

Quick Quiz 2

State whether the following are true or false in terms of the King IV Report:

- The chair of the audit committee should be the chair of the board; FALSE
→ Principle 7.36.a specifically states the Chair of the board may not be a member of the audit committee
- The CEO must chair the remuneration committee; FALSE
→ The Chair of the remuneration & audit committee must be INED
- The nominations committee should consist of only non-executive directors.
TRUE
→ All members must be NEDs with majority being Independent

King IV Report

The Governance of Risk

The board should exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the companies business.

Who is responsible for what?

WHAT	WHO
Governance of Risk?	The governing body
Implement and execute the risk management plan	The governing body should delegate it to management
Monitor the risk management process?	The governing body, risk committee, audit committee
Performing an objective assessment of the effectiveness of risk management?	Internal audit



King IV Report

The Governance of Risk

Study: King IV Report (2016: 61 – 62) and Jackson & Stent (2016: 4/40 – 4/43)

King IV Report

The Governance of Information Technology

- The board should be responsible for IT governance
- The board should ensure that IT is aligned with the performance and sustainability of the company
- The board should delegate to management, the responsibility for the implementation of an IT governance framework
- The board should monitor and evaluate significant IT investments and Expenditures
- IT should form an integrated part of the company's risk management and the board should ensure that information assets are managed effectively
- The audit or risk committee should assist the board to carry out its responsibilities

King IV Report

The Governance of Information Technology

Study: King IV Report (2016: 62 – 63) and Jackson & Stent (2016: 4/43 – 4/46)

King IV Report

Compliance Governance

The board should ensure that the company complies with applicable laws, rules, codes and standards.

The governing body should delegate the responsibility for implementation and execution of effective compliance governance to management.

The governing body should **monitor and oversee compliance** and **disclose** details in the integrated report

King IV Report

Compliance Governance – Company Secretary

- Governing body should ensure it has access to professional and independent guidance on corporate governance and its legal duties.
- For some companies, the appointment of a company secretary is a statutory requirement.
- King IV recommends appointing a company secretary or other professional as appropriate for the organisation, to provide professional CG services.

King IV Report

Compliance Governance – Company Secretary

The Company secretary should:

- Be suitably qualified, competent and experienced
- Have an “arms’-length” relationship
- Not be a director
- Prepare and circulate governing body papers
- Elicit responses, input, feedback for governing body and its committee meetings
- Ensure preparation and circulation of minutes of governing body and committee meetings



King IV Report

Compliance Governance

Study: King IV Report (2016: 63 – 64) and Jackson & Stent (2016: 4/46 – 4/47)

King IV Report

The Governance of Remuneration

- Remuneration policies should be designed to:
 - Attract, motivate, reward and retain human capital
 - Promote the achievement of strategic objectives
 - Promote positive outcomes
 - Promote an ethical culture and responsible corporate citizenship

King IV Report

The Governance of Remuneration

- Elements of remuneration offered should be set out in the remuneration policy:
 - Base salary
 - Variable remuneration
 - Payments on termination of employment or office
 - Sign-on, retention and restraint payments
 - Commissions and allowances
 - Fees of non-executive members of the governing body
 - Etc



King IV Report

The Governance of Remuneration

Study: King IV Report (2016: 64 – 67) and Jackson & Stent (2016: 4/47 – 4/50)

King IV Report

Assurance

Principle 15 states:

“The governing body should ensure that assurance services and functions enable an effective control environment and that these support the integrity of information for internal decision-making and of the organisation's external reports.”

King IV Report

Assurance

Combined assurance model:

- Incorporates and optimizes all assurance services and functions to enable an effective control environment, support the integrity of info used for internal decision-making, and support the integrity of external reports.

King IV Report

Assurance

Internal Audit

- Board ensure an effective **risk based** internal audit
- Should follow an approved **risk based internal audit plan**
- Should provide an **overall statement annually** to the effectiveness of the organisation's governance, risk management and control processes.
- The audit committee should be **responsible** for overseeing internal audit
- Should be **strategically** positioned to achieve its objectives
- External, independent quality **review of internal audit function** should be conducted at least once every five years.

Quick Quiz 3

- Why should the internal audit function be independent and not partake in the day-to-day management or operations of the company?
- Who oversees the internal audit function?
- To whom does the Chief Audit Executive report to?
- Who appoints the Chief Audit Executive?
- Should the CAE be a member of the governing body?

Quick Quiz 3

- Why should the internal audit function be independent and not partake in the day-to-day management or operations of the company?
 - To stay independent
- Who oversees the internal audit function?
 - The audit committee (principle 15.48)
- To whom does the Chief Audit Executive report to?
 - The chair of the audit committee on performance of duties and functions
 - Appointed member of executive management on other duties and administrative matters (principle 15.56)
- Who appoints the Chief Audit Executive?
 - The governing body (principle 15.52)
- Should the CAE be a member of the governing body?
 - No, the CAE is not a director, and for reasons of independence.

King IV Report Assurance

Study: King IV Report (2016: 68 – 70) and
Jackson & Stent (2016: 4/51 – 4/55)

King IV Report

Stakeholder Relationships

- King IV Report emphasizes a “Stakeholder inclusive” approach to governance
- **Stakeholder perceptions** affect a companies reputation
- Company to proactively manage relationships with stakeholders
- Achieve correct balance between various stakeholder groups
- Equitable treatment of shareholders
- **Transparent** and effective **communication** with stakeholders
- Governing body should ensure disputes are resolved effectively, efficiently and expeditiously as possible

King IV Report

Stakeholder Relationships

Main categories of stakeholders:

Suppliers	Creditors
Government (e.g. SARS)	Employees
External auditors	Consumers / Customers
Industry	Local Communities
Regulators	Media
Potential investors	Shareholders



King IV Report

Stakeholder Relationships

Study: King IV Report (2016: 71 – 73) and Jackson & Stent (2016: 4/55 – 4/59)

Corporate Governance

Activities:

- Do all the activities related to this Topic

Tutorial letter 102:

- Do all questions under topic 1 from the prescribed textbook, *Graded Questions on Auditing* (2017)

Assignments and past examination papers:

- Do the assignments (tut 101) and past examination questions (on myUnisa) to see how this topic could be examined
- Remember to read the scenario and the questions carefully, and answer what was asked!
- Remember that Corporate Governance only account for approximately 25% of the exam – do not spend more than 25% of your time on this Topic.
- This is easy marks!

EXAM TECHNIQUE

- When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. You will notice that marks are available for **applying** the information in the scenario to the requirements of the King IV Report.

Old exam paper question

- Do questions 1.1 and 1.2 of May 2017 exam paper

TOPIC 2

Internal Control

What is an Internal Control?

It is procedures designed to address and limit potential risks

Types of risks

- Safeguarding assets of a company
- Preventing fraud
- Complying with laws and regulations
- Producing reliable financial information → Financial statements
- Effective and efficient operation of business

Internal Control

Are internal controls 100% foolproof?

No, as no single control can neatly address each identified risk. Thus as internal controls can be fallible, they work best in combination.

E.g. Whilst a student card is required to enter the university library, the security guard at the entrance gate should inspect the photo on the student card to confirm that the person entering the library is indeed the authorized user for that card.

Note that there are two controls in place before you can enter the library:

1. **Presenting** your student card
2. **Inspection** of the student card by the security guard

Internal Control

What are the key characteristics of internal controls?

- Is a process
- Effected by people
- Not the sole responsibility of management
- Is not static
- Is not fool proof
- Is not a case of a single control addressing a single risk

Note: In the exam you should be able to elaborate on the above. Refer to Jackson and Stent (2016: 5/4 – 5/5) for detailed explanations

Internal Control

Taking the above into account, internal controls can be defined as follows:

Definition:

ISA 315 **defines internal control** as the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to:

- The reliability of the entity's financial reporting
- The effectiveness and efficiency of its operations
- Its compliance with applicable laws and regulations

Internal Control

Does internal controls have limitations?

Yes, as internal controls does not provide absolute assurance that the risks, that threaten the achievement of the objectives of the business, will be adequately responded to. This is due to the **inherent limitations** of internal controls

What are the **Inherent limitations** of internal controls?

- **Cost** of internal control does not exceed the expected benefit
- Tendency to be directed at **routine** transactions
- Potential for **human error**
- Possibility of circumvention of internal controls through **collusion** (conspiracy)
- **Management overriding** an internal controls – abuse of responsibility
- **Changes** in conditions resulting in internal controls becoming **inadequate**

Internal Control

Who is responsible for internal controls in the business?

Everyone is, this includes the board of directors, management and employees.

- The board has overall responsibility and accountability
- Management identify risks, design and implement policies and procedures to address risks.
- Employees execute internal control procedures.

Thus the success of internal controls depends on **all parties** involved.

Internal Control

Components of internal control

What are the components of internal control?

There are **five** components to internal controls, they are:

- Control environment
- Risk assessment
- Information systems
- Control activities
- Monitoring of controls

Internal Control

Components of internal control

1. Control environment

The control environment sets the **tone** of the entity and creates the **atmosphere** in which employees go about their duties. The desirable mind set is one of “doing things the right way”

Points relating to this component:

- * Integrity and ethical values
- * Commitment to competence
- * Participation of those charged with governance (e.g. Board of directors)
- * Management's philosophy and operating style organisational structure
- * Assigning authority and responsibility
- * Human resource policies and practices.

Internal Control

Components of internal control

2. Risk Assessment

King IV states that the board should ensure that risk assessments are performed on a continual basis. Risk assessment is important because internal controls are designed and implemented as a **response** to assessed risk. It is therefore critical that the risk assessment process is comprehensive, accurate, thorough and complete.

Points relating to this component:

- * Define the objectives of entity, the departments and functions
- * Identify and assess risks: Operational, financial reporting and compliance
- * Respond to risk:
 - information system (combined process / method of initiating, recording, processing and reporting transactions, manually / through computers / a combination of both)
 - control activities

Internal Control

Components of internal control

3. Information System

The objective of the information system and its subpart, the accounting system, is to produce information that is **Valid, Accurate and Complete** and **timeously** produced

Points relating to this component:

- * Valid, accurate and complete (when initiating, recording, processing and reporting transactions)
- * Procedures to deal with transactions: initiating, recording, processing, correcting, and posting (to ledgers)
- * Related accounting records: documents used, document
- * Capturing events and conditions other than transactions (e.g. depreciation)
- * Journal entries
- * Accumulate, record, process and summarise information for the preparation of the financial statements

Internal Control


Components of internal control

4. Control Activities


Control activities are the **actions** carried out to **manage** or **reduce** risks and to achieve the entity's objectives.

Types of control activities include:

- Approval, authorization
- Segregation (division) of duties
- Isolation of responsibility
- Access/Custody
- Comparison and reconciliation
- Performance reviews



Make sure you understand the difference between Segregation of duties and Isolation of responsibilities



There is no point in comparisons and recons if differences are not followed up and remedial actions taken

Control activities can be **Preventative**, **Detective** or **Corrective** in nature.

Internal Control

Components of internal control

5. Monitoring of controls

The monitoring of controls involves the **assessment** of internal control performance over time. If controls are not monitored, the board or management will not know if the entity's financial reporting is reliable and whether the laws, regulations and company policies are being complied with.

Points relating to this component:

- * Assessment over time
- * Are objectives still being met?
- * Assessment at all levels: directors, management, department heads
- * Independent assessment: internal audit, external bodies, customers
- * Remedial action

Controls in a Computerized Environment

What controls are there in a computerized environment?

1. General controls
2. Application controls

Note: General and application controls can be **manual** (performed by humans) or **computerized** (performed by the computer)

Does controls in a computerized environment touch on all components of internal controls?

Yes, refer to your MO001, page **61** for a diagrammatic representation illustrating how general and application controls relate to **all the components of internal controls**

Controls in a Computerized Environment

General controls

Are defined as those controls which establish an **overall framework** of control for computer activities.

They are controls which should be in place **before** any processing of transactions gets underway and they span **across all applications**.

As general controls operate “**around**” the application controls, if your general controls are not adequate, the application controls might not be of much use.

Controls in a Computerized Environment

General controls

General controls can be categorized under the following headings:

- Control environment
 - Management's attitude
- Systems development and implementation controls
 - In-house development and implementation, packaged software, programme change controls
- Access controls
 - Access to hardware, accessing the computer itself, documentation
 - Physical access (e.g. access cards) vs Logical access (e.g. passwords)
- Continuity of operations
 - Risk assessment, physical security, disaster recovery
- System software and operating controls
- Documentation
 - Sound document controls and standards

Controls in a Computerized Environment

Application controls

Are any control within an **application** which contributes to the **accurate** and **complete** recording and processing of transactions which have actually **occurred (valid)**, and have been authorized (Occurred, accurate and complete information)

The stages through which a transaction flows through the system can be described as:

- **Input** (e.g. read in sales transaction)
- **Processing** (e.g. calculate VAT on sales transaction)
- **Output** (e.g. printout of invoice on sales transaction)

Application controls can be described in terms of these activities, e.g. an application control relating to input.

Controls in a Computerized Environment

Application controls

Application controls can be categorized under the following headings:

- Segregation of duties
- Isolation of responsibilities
- Approval and authorisation
- Custody
- Access controls
- Comparison and reconciliations and follow up of discrepancies
- Performance review

Controls in a Computerized Environment

Application controls

Application controls must also be implemented over the **masterfile**. A masterfile is a file which is used to store only standing information and balances. The masterfile is a very important part of producing **reliable** information and must be **strictly controlled**. E.g. The debtors masterfile will contain name, address credit limit etc.

What are the objectives of controls in a computerized environment centered around?

1. Occurrence and authorization

- Data and transactions are **not** fictitious
- Data and transactions are in accordance with the activities of the business and have been properly **authorized** by management

Controls in a Computerized Environment

2. Accuracy

Is concerned with **minimizing errors** by ensuring data and transactions are correctly captured, processed and allocated

3. Completeness

Is concerned with ensuring that data and transactions are **not omitted** or incomplete

Controls in a Computerized Environment

Framework for application controls

	Occurrence and authorisation (Valid)	Accurate	Complete
Input			
Processing			
Output			
Masterfile			

Controls in a Computerized Environment

Study: Jackson & Stent (2016: 8/3 – 8/4 and 8/7-8/25 and 8/26- 8/41)

When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. This will give you an idea as to how controls in a computerized environment can be tested in an examination

Internal Control

from the Perspective of the External Auditor

Why must an external auditor obtain an understanding of a clients system of internal control?

An understanding of a clients system of internal control assists the external auditor to:

- Identifying types of **potential misstatements** and factors that affect the **risks of material misstatement**, and
- in **designing** the nature, timing and extent of further **audit procedures**.

What is a significant risk?

Significant risks are risks that require **special audit consideration**. Such risks relate to the auditors **risk of material misstatement**. The auditor assesses risk so that he or she can **determine** the nature, timing and extent of further audit procedures.

Internal Control

from the Perspective of the External Auditor

Study: Jackson & Stent (2016: 7/15 – 7/22)

When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. This will give you an idea as to how internal controls from the perspective of the **external auditor** can be tested in an exam.

Topic 2: Internal controls

Activities:

- Do all the activities related to this Topic

Tutorial letter 102:

- Do all questions under topic 2 from the prescribed textbook, *Graded Questions on Auditing* (2017)

Assignments and past examination papers:

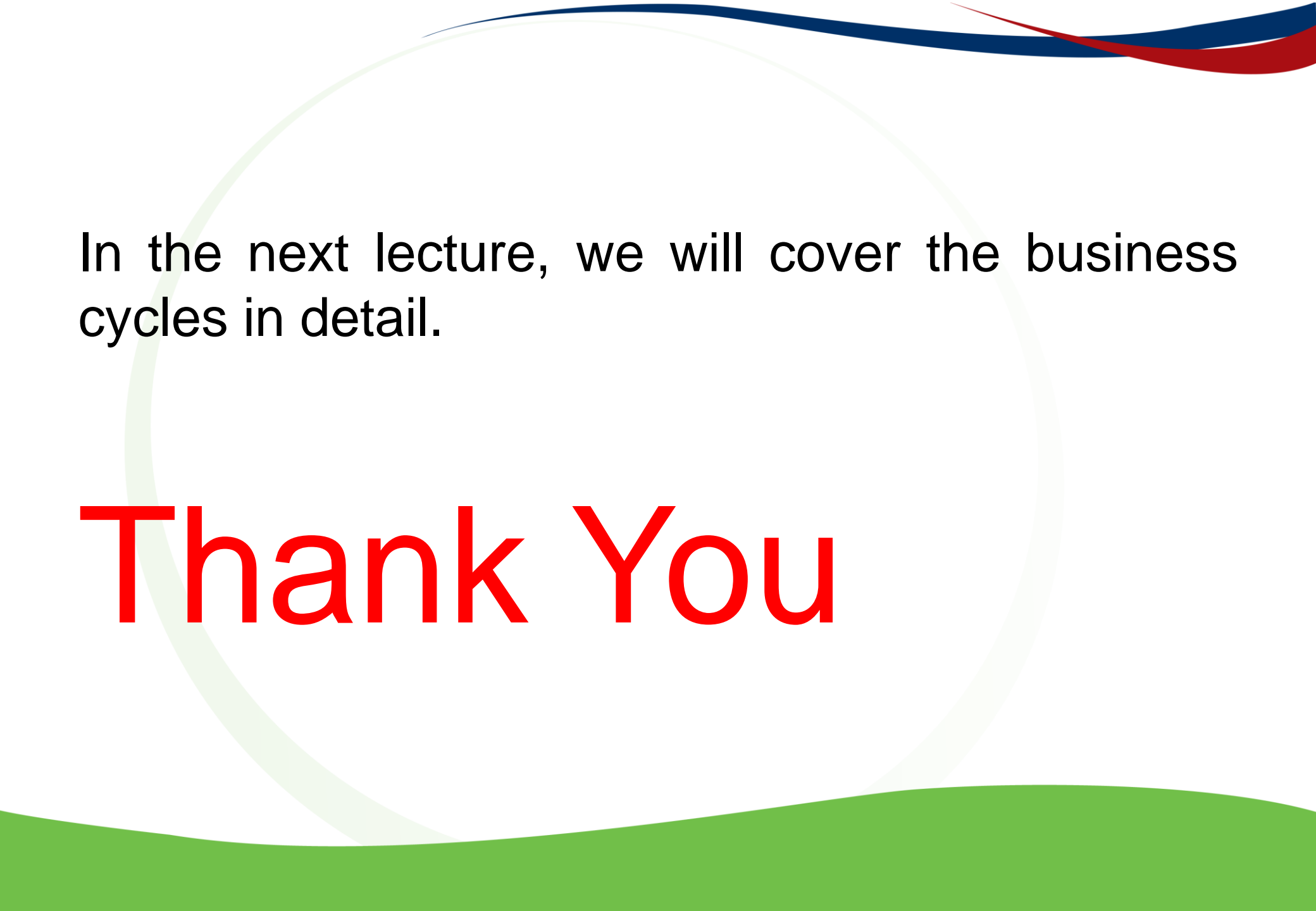
- Do the assignments (tut 101) and past examination questions (on myUnisa) to see how this topic could be examined
- Remember to read the scenario and the questions carefully, and answer what was asked!

EXAM TECHNIQUE

- When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented.

Old exam paper question

- Do questions 1.3 and 1.4 of May 2017 exam paper



In the next lecture, we will cover the business cycles in detail.

Thank You