

# AUE 2602

## Corporate Governance in Accountancy

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# Important Information

Assignment 1 due: **13 April 2018** (5%)

Assignment 2 due: **13 April 2018** (15%)

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

# 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

# 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

# Weakness, Risk and Internal Controls

It is important for you to be able to differentiate between a weakness, a risk and an internal control.

## Weaknesses

(The internal control that is not there.

What is the company currently doing wrong?)

## Risks

(What is the consequence of the weakness, what can go wrong, the financial implication?)

## Internal controls

(What should be implemented to mitigate the risks?)

# Weakness, Risk and Internal Controls

- You should be able to identify weaknesses and risks in a business cycle, in order to be able to understand and apply internal controls in the cycle.
- When you do questions on weaknesses, risks and internal controls:
  1. Determine in which **cycle** you're in. For example - Receipts and Revenue
  2. Determine in which **function** you're in. For example – Receiving Customer Orders (Jackson & Stent p10/10)
  3. **What is being asked** – is it weaknesses, risks or internal controls? If the question asks for weaknesses, and you give internal controls / risks, you will not receive any marks. So read the questions very carefully.

# Topics 4-8

Learning units of each topic

1. Activities and Functions
2. Documents
3. Risks and Internal controls in a manual system
4. Risks and internal controls in a computerised system

# Topics 4-8

Remember the functions of each cycle?

For each function you need to know:

- The **objective** of the function
- The **documents/records** used in the function
- The **risks** present in the function
- The **control activities** to mitigate/reduce the risk

**Note:** This knowledge will also be very useful to you in your later studies and future careers, so put the effort in now, and reap the rewards later



# Revenue and Receipts cycle

When you study risks and internal controls, **do the following:**

- **Link** each internal control to a risk / risks for each of the functions
- Explain to yourself why was something identified as a risk (financial disadvantage?) and how will the internal control mitigate that risk.
- Risks and internal controls become more logical and therefore easier to remember in the exam
- Remember the **“What, on what, why and by whom”**

## TOPIC 4

### Revenue and Receipts Cycle

In business, revenue is income that arises in the course of ordinary activities of an entity from the sale of **goods** and **services** to customers

Depending on the type of business activities, some companies might also receive revenue from the **fees, interest, dividends** or **royalties**

# Revenue and Receipts cycle

## Risks and internal control in the cycle for credit sales

Let us take an example of the first function in the revenue and receipts cycle, the **Order department – Receiving customer order (J&S p10/10)**

### Risks

1. Order may be accepted from non-account holder  
→ May result in sales made to customer who does not pay his account
2. Orders may not be acted upon timeously or at all  
→ Could result in loss of sales and customer goodwill
3. Inaccurate or incomplete order details may be recorded  
→ May result in incorrect deliveries, returns & customer dissatisfaction

# Revenue and Receipts cycle

**RISK:** Orders may be accepted from a non-account holder

## **INTERNAL CONTROLS:**

No orders to be accepted if the customer is not an approved customer.

1. Inspect the approved customer list *(if he's on the list there was a background/credit score check done)*
2. Order clerk to request customer's account number *(if he has an account number, chances are he's on the approved customer list)*
3. Order clerk to sign all ISOs to indicate performance of control activity *(the order clerk takes responsibility and is saying that he did in fact check to see if this is an approved customer)*



## TOPIC 5

### Acquisition and Payments cycle

Goods, services and assets are acquired and paid for in order to continue with business activities that will generate revenue.

# Acquisitions and Payments Cycle

## Risks and internal control in the cycle

Let us take an example of the first function in the acquisitions and payments cycle, the **Ordering of Goods and Services (J&S p11/9)**

### Risks

1. Ordering of incorrect or unnecessary goods  
→ could result in liquidity problems and wastage
2. Ordering unauthorised goods  
→ could result in losses to the company through fraud
3. Requisitions not acted upon / orders not placed timeously or at all  
→ could result in losses to company due to delay in e.g. production
4. Obtaining inferior quality goods  
→ could result in losses to company due to delay in e.g. production
5. Paying unnecessarily high prices for good  
→ could result in losses to company due to overpayment of goods

# Acquisitions and Payments Cycle

**RISK:** Ordering of incorrect or unnecessary goods

## INTERNAL CONTROLS:

1. The stores personnel should confirm that goods are really needed *(If it is not needed, it is unnecessary)*
2. Before an order is placed, a senior buyer should check the order to requisition for accuracy and authority *(if it was not authorised it really needed? Is the actual goods / quantity correctly indicated?)*
3. Before order is placed, a senior buyer should review order for suitability of supplier *(if you manufacture paint, and the order from an ice cream parlor, is it a suitable supplier?)*

## TOPIC 6

# Inventory and Production Cycle

Inventories encompasses goods purchased and held for resale, including merchandise purchased by a retailer and held for resale.

Inventories also encompass:

- Raw materials
- Work in progress
- Finished goods produced



# Inventory and Productions Cycle

This topic is divided into the following learning units:

1. Activities and functions in the cycle
2. Documents used in the cycle
3. Risks and internal controls (warehousing)
4. Risks and internal controls (production)
5. Inventory counts
6. Computerisation of the cycle
7. Inventory valuation concepts

# Inventory and Production Cycle

## Basic requirements of this cycle

As the inventory cycle is internal, it must achieve three things:

- Control the physical **transfer** (movement) of inventory
- Protect the inventory from **damage, loss** and **theft**
- Plan, control and record the **costs** of manufacture

**Refer to** Jackson and Stent (2016: 12/3- 12/4) for a detailed discussion

# Inventory and Production Cycle

## Warehouse function

**RISK:** Goods received from suppliers are not transferred into the warehouse timeously or at all

### **INTERNAL CONTROLS:**

1. No movement of inventory should take place without an authorising document

# Inventory and Production Cycle

## Fraud in the cycle

Refer to Jackson & Stent 2016: 12/20 – 12/21

Fraud in this cycle can occur through:

- Fraudulent financial reporting
- Misappropriation of assets

It is very interesting to see to what lengths people will go to manipulate the inventory balance.

# Inventory and Production Cycle

## Inventory counts

One of the most common control activities: whereby actual inventory on hand is counted and compared with the theoretical inventory in the accounting records

The responsibility for carrying out “inventory counts” rests with management, since it is managements responsibility to ensure that the inventory figure in the financial statements is valid (exists), accurate and complete

**Study:** Jackson & Stent (2016: 12/11- 12/13) to understand the controls that should be present when conducting an inventory count

# Inventory and Production Cycle

The differences between a cycle count and an annual count:

Cycle counts	Annual count
More regular – e.g. once every 3 weeks	Only at financial year end
Only some inventory is counted – e.g. high value items	All inventory must be counted
Comparisons to perpetual inventory records	Comparison to theoretical inventory records (not necessarily perpetual records)
Some additional procedures to take into account - p12/11	
For both counts	
Sound count controls and method of physical counting is the same (p 12/12 – 12/13)	
Discrepancies must be thoroughly investigated and followed up on	

It is very **NB** for you to **read the question carefully** – answer what was asked!!!

# Inventory and Production Cycle

## Inventory and valuation concepts

IAS 2 state that inventory should be measured (valued) at the lower of Cost and Net Realisable Value (NRV)

It is important that inventory should be valued accurately as the internal control objectives of validity, accuracy and completeness may be at risk if the inventory in the financial records is either over- or undervalued

**Study:** Jackson and Stent (2014:12/18 – 12/20) section 3

# Inventory and Production Cycle

Cost formulas that can be used:

- Specific identification
- Weighted average cost
- FIFO

Cost of inventory include:

- all costs of purchase including import duties, transport costs, etc.
- costs of conversion
- costs in bringing inventory to present location and condition
- It excludes: → storage costs, admin costs, selling costs

Cost of manufacturing of goods include:

- allocation of overheads to cost of inventory → fixed and variable production overheads,
- @ normal capacity
- It excludes: → abnormal waste



## TOPIC 7

# Payroll and Personnel Cycle

Two main types of transactions are processed through the payroll and personnel cycle namely:

- Payment to employees for services rendered (Salaries and wages)
- Accrual and payment of payroll related liabilities (Taxes, pension fund, etc.)

# Payroll and Personnel Cycle

## Risks and internal control in the cycle

Let us take an example of the first function in the payroll and personnel cycle, the **Personnel (Human Resources) function** (J&S p13/9)

### Risks

1. Recruiting/retaining unsatisfactory or unnecessary employees  
→ cost to company, loss in profit
2. Incorrect dismissal procedures  
→ could result in lawsuits being filed against company leading to decrease in profit
3. Unauthorised amendments to employee records:
  - 3.1 Fictitious additions
  - 3.2 Unauthorised changes in wage rates→ could result in unnecessary expenses for company, leading to decrease in profit
4. Inaccurate or incomplete records

# Payroll and Personnel Cycle

**RISK:** Recruiting/retaining unsatisfactory or unnecessary employees

## INTERNAL CONTROLS:

1. All requests for the appointment of employees should originate from the section making the request, e.g. factory, etc and should be in writing & a motivation provided *(to prevent employment of unnecessary employees)*
2. Requests should be signed by the section head and countersigned by the section manager after ref to budget *(to prevent employment of unnecessary employees)*
3. Sound personnel practices should be followed to obtain honest, competent personnel: interviews, background checks, etc *(to prevent appointment of unsatisfactory employees)*

## TOPIC 8

# Finance and Investment Cycle

Investing and finance activities consist of transactions that relate to the acquisition of the **non-current assets (fixed assets)** which are required to manage the activities of the enterprise.

The financing activities include funds obtained from borrowing, finance leases and operating leases.

# Finance and Investment Cycle

## What are the characteristics of this cycle?

### 1. Frequency of transactions

- Transactions in this cycle **do not** generally occur every day.

### 2. Size of transactions

- Transactions are usually **material** (amounts are large)

### 3. Legal and regulatory requirements

- Transactions are governed by statute and the **MOI** of the company

### 4. Non routine internal controls

- Transactions **not** subjected to routine every day control

# Finance and Investment Cycle

## What are the characteristics of this cycle?

### **5. Non standard documentation**

- Unlikely that documentation will be standard every day documentation.

### **6. Major risks within the cycle**

- Client understates completeness of long term liabilities
- Client overstates existence and valuation of investments
- Invalid transactions occur (legal and regulatory requirements)

# Finance and Investment Cycle

## Compensating controls

### 1. Planning

- Transactions should be carefully planned by senior experienced management

### 2. Authorization

- Authorization for material transactions should be at the highest level

### 3. Implementation

- If transaction not straightforward, it should be carried out by competent staff and properly controlled

### 4. Review and approval

- Transactions subject to: Progress reporting, comparisons to budgets, etc.

**Refer to Jackson and Stent (2016: 14/3- 14/5) for a detailed discussion**

# TOPICS 4-8

## What is a Masterfile?

The masterfile contains the “Permanent” or “Semi-permanent” information.

e.g. Debtors masterfile (R&R Cycle) would contain inter alia:

- The customer's name
- The customer's account number
- The customer's ID number / Company registration number
- The customer's physical and postal address
- The customer's credit limit as determined by credit controller / manager
- The customer's repayment terms (e.g. 30, 60 or 90 days)

Refer to Jackson & Stent (2016: 10/23 - 10/25) for the internal controls pertaining to the Debtors Masterfile



## TOPICS 4-8

***NB!!!***

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. Also take note of how this topic is normally tested at your level of study.

# **Revenue and Receipts Risks – May 2017**

## **1. Ordering of wood**

To enhance local employment rates, all wood is ordered from the local forestry department by the Senior Buyer, Ms S Storm.

# Revenue and Receipts Risks – May 2017

Question 2.1 (15 marks + 2 presentation marks)

**Describe** any **FIVE (5) risks** linked to the **ordering of goods function** of the **acquisition and payments cycle**. **Explain** why each risk is considered a risk.

Present your answer in the following format:

No marks will be awarded for the example below.

Risk	Explanation
Example: Paying unnecessarily high prices for goods	Example: This could result in liquidity problems and financial loss
1)	
2)	
3)	
4)	
5)	

# Revenue and Receipts

## Risks – May 2017

RISK	EXPLANATION
Ordering of incorrect or unnecessary goods (1½)	This could result in liquidity problems and wastage (1½) OR Loss of production (1½)
Ordering unauthorized goods(1½)	This could result in losses to the company through fraud (1½) OR This could result in liquidity problems and wastage (1½)
Order forms misused e.g. for placing orders for private purchases (1½)	This could result in losses to the company through fraud (1½) OR This could result in liquidity problems and wastage (1½) OR This could result in obtaining unauthorised goods. (1½)
<u>Requisitions</u> not acted upon or orders not placed timeously or at all (1½)	This could result in loss of production time which ultimately could lead to loss of sales / customer goodwill (1½)
Obtaining inferior quality goods (1½)	This could result in loss of production time which ultimately could lead to loss of sales (1½) OR Loss of customer goodwill (1½)
Ordering from an unauthorised supplier (1½)	This could result in obtaining inferior quality goods (1½) OR This could result in losses to the company through fraud (1½) OR This could result in paying higher prices for goods (1½)
<u>Orders placed</u> with suppliers not filled or not timeously filled (1½)	This could result in loss of production time which ultimately could lead to loss of sales (1½)

# Acquisition and Payment cycle

## Internal controls - Oct 2017

### 2. Receiving of goods

Mr Curry established a designated secure area in the warehouse, to receive goods that was ordered by the order department. Only necessary and relevant employees have access cards to gain access to this section. Mr Curry is not aware of any other internal controls which can be implemented to mitigate the risks that arise when receiving goods.

# Acquisition and Payment cycle

## Internal controls - Oct 2017

### Question 2.2 (12 marks)

Describe **EIGHT (8) additional manual (non-computerised) internal controls** that should be in place to mitigate the risks in the **receiving of goods function**.

# **Acquisition and Payment cycle – RISK**

## **Oct 2017**

Straightforward theory question  
Jackson & Stent 2016 p11/10

# Inventory and Production Cycle

## Weakness – Oct 2016

### Inventory

Worldwide Toys' inventory is kept in a single tidy warehouse in Sandton, Johannesburg. An inventory count is conducted on an annual basis and the following procedures are followed:

1. The count takes place over two days for Worldwide Toys to receive and despatch goods during the second day of the count.
2. Eight warehouse employees are part of the count team and they each count a section of the warehouse on their own.
3. The warehouse administrator hands out the numerically sequenced inventory sheets with the description and quantity per item to the counters who count their section of the warehouse and tick off the quantities on the inventory sheets once they have counted the items.



# Inventory and Production Cycle Weakness – Oct 2016

## Question 3.4 (9 marks)

**Discuss** the **weaknesses** in the year-end inventory count based on the information in the scenario.

# Inventory and Production Cycle

## Weakness – Oct 2016

1. The count is held over two days to allow for trading – they should rather use non-trading days or overtime for the count
2. They dispatch goods during the count – this should be avoided to ensure a more accurate count
3. The use of only warehouse employees is a weakness as there are no independence
4. Each counter counts alone which does not allow for independence and accuracy – there should be two in a team, one of which should be independent
5. The quantity of the goods is already filled in, this does not force the counters to actually count the goods
6. Counters only tick off on the count sheet – there is no indication of what the counters should do if there are discrepancies
7. There is no indication that the counted items are marked in any way, which could lead to double counting



In the next session, we will cover  
exam preparations and the exam scope

**Thank You**