

# Tutorial Letter 202/1/2015

## CORPORATE GOVERNANCE IN ACCOUNTANCY

### AUE2602

### Semester 1

### Department of Auditing

**IMPORTANT INFORMATION:**

KEY TO ASSIGNMENT 02 FOR THE FIRST  
SEMESTER 2015 AND OTHER ASSESSMENT

BAR CODE

**Please note:**

**This tutorial letter contains the key to and comments on Assignment 02.**

## **ASSIGNMENT 02 – FIRST SEMESTER**

### **QUESTION 1**

**6 marks**

**Compliance to the King III Report with regards to the composition of the board of directors**

**Reference:** The King III Report (2009:29–53)

The existing board **does not comply** with the recommendations of the **King III Report** in the following respects:

1. Mr M Shoemaker is the chief executive officer (CEO). The King III Report recommends that the chairman should be an independent non-executive director. (principle 2.16) (1½)
2. Mr M Shoemaker should not be both chairman and CEO; it is recommended that the CEO of the company should not also fulfil the role of the chairman of the board. (principle 2.16) (1½)
3. In the case where the CEO and chairman is the same person, the board should appoint a lead independent non-executive director to act as chairman when any situation of conflict of interest arises for the chairman. Motor Mania Limited currently does not have any independent non-executive directors. (principle 2.16, point 38) (1½)
4. The board does not comprise a balance of executive and non-executive directors; there is only one non-executive director to five executive directors. There should be a majority of non-executive directors and the majority of the non-executives should be independent. (principle 2.18) (1½)
5. There are no independent non-executive directors: Mr M Vebber represents a shareholder who owns 28% of the company and will have his uncle's interests as his prime consideration. Therefore he cannot be considered as independent. (1½)

**(1½ marks for each valid statement to the maximum of 6 marks)**

### **Comment**

Did you notice how the answer was limited to the composition of the board of directors, and only non-compliance was discussed? You should always read your questions carefully, in order to answer what was asked, and not waste precious time.

### **QUESTION 2**

**6 marks**

**Comments on the risk committee**

**Reference:** The King III Report (2009:29-53)

- a) This is incorrect. The King III Report requires that the members be a mix of executive and non-executive directors. It is essential that there be executive directors on the committee as they will have a better insight into the operational and other “day-to-day” risks than a

non-executive director. Senior members of management should, where necessary, attend the meetings (principle 4.3, point 20). (1½)

- b) The King III Report's only stipulation regarding the chair of the risk committee is that it should be an independent non-executive director. The chairman of the board of directors should be an independent non-executive director, and may therefore also chair the risk committee. However, in the scenario, Mr M Shoemaker (the chairman of the board of directors and CEO) is not an independent non-executive director, and therefore, he should not chair the risk committee (principle 2.23, point 131). (1½)
- c) The King III Report recommends that the risk committee convene at least twice a year. The number of times it does convene (more than twice) will depend upon the needs of the company and will be determined by the chairman of the committee (principle 4.3, point 22). (1½)
- d) The risk committee should have a minimum of three members but there is no limit to the number of members (principle 4.3, point 21). (1½)
- (1½ marks for each valid statement, to the maximum of 6 marks)**

### QUESTION 3

**18 marks**

#### Risks in the recording of sales in the revenue and receipts cycle

**Reference:** Jackson & Stent (2015:10/15)

INTERNAL CONTROL	RISKS WHICH WILL BE MITIGATED
1. Invoices are recorded in the sales journal in numerical sequence.	<ul style="list-style-type: none"> <li>• The risk of sales invoices being omitted from the sales journal can be prevented. (1½)</li> <li>• The risk of invoices being duplicated in the sales journal can be prevented. (1½)</li> </ul>
2. The numbers of any cancelled invoices are recorded in the sales journal and marked as "Cancelled".	<ul style="list-style-type: none"> <li>• The risk of invoices being omitted from the sales journal can be prevented. (1½)</li> <li>• The risk of invoices being duplicated in the sales journal can be prevented. (1½)</li> </ul>
3. Prior to recording the sales invoices in the sales journal, the amounts on the invoices are added to obtain a control total. This control total is then compared to the total in the sales journal after the individual invoices have been recorded (batch control system).	<ul style="list-style-type: none"> <li>• The risk of invoices being duplicated in the sales journal can be prevented. (1½)</li> <li>• The risk of invoices being inaccurately entered in the sales journal can be prevented. For example, R9,60 instead of R6,90. (1½)</li> </ul>
4. An independent staff member checks the sequence of the invoices recorded in the sales journal and follows up on any missing invoices.	<ul style="list-style-type: none"> <li>• The risk of invoices being omitted from the sales journal, which would lead to incomplete accounting records and revenue being understated in the financial statements, can be prevented. (1½)</li> <li>• The risk of invoices being duplicated in the sales journal can be prevented. (1½)</li> </ul>

INTERNAL CONTROL	RISKS WHICH WILL BE MITIGATED
5. An independent staff member compares the customer name and amount recorded in the sales journal to the invoice for accuracy.	<ul style="list-style-type: none"> <li>• The risk of invoices being inaccurately entered in the sales journal can be prevented. For example, R9,60 instead of R6,90. (1½)</li> <li>• The risk of invoices being entered against an incorrect debtor when posting to the debtors' ledger accounts can be prevented. (1½)</li> </ul>
6. An independent staff member checks the postings (transfers) from the sales journal to the debtors' ledger (individual debtors) and the general ledger.	<ul style="list-style-type: none"> <li>• The risk of invoices being entered against an incorrect debtor when posting to the debtors' ledger accounts can be prevented. (1½)</li> </ul>

**(1½ marks for each valid risk to the maximum of 10 marks)**  
**(1½ marks for correct presentation)**

### Comment

In this scenario you were provided with the internal controls, and had to name the risks that it mitigated. Therefore, you had to state the reason why these internal controls have been implemented. If you understand the “why” of risks and internal controls, it becomes much more logical and therefore easier to remember during the exams.

### QUESTION 4

**24 marks**

#### **Computerised internal controls on electronic funds transfer (EFT) salary payments**

**Reference:** Jackson & and Stent (2015:13/25-13/26)

1. At least two of the three authorised employees will be required to effect the payment of salaries. For example, the payroll administrator, Ms N Bossberg, will authorise the payment. The head of the personnel section, Ms V Bothas, will then release it. (1½)
2. Once the payroll administrator, Ms N Bossberg, is satisfied with the payroll she will select the “first confirmation” option (1½) and a system-generated message will be sent to the head of personnel, Ms V Bothas, informing her that the payroll file is awaiting her approval. (1½)
3. The head of personnel, Ms V Bothas, will then access the file of payments and carry out whatever procedures she deems necessary to be in a position to authorise the payments. For example, review of reasonableness, access of masterfile amendment logs, and reference to original documentation. (1½)
  - The second “signatory”, the head of personnel, Ms V Bothas, will not have write access to the file so she cannot for example, add additional fictitious employees to be paid. (1½)
  - Once Ms V Bothas, the second “signatory” is satisfied, she will click on “second confirmation”. (1½)
  - The “second confirmation” cannot be activated before the “first confirmation”. (1½)
4. The file of payments will now be fully approved, and by clicking on the second confirmation the file will automatically convert to a format compatible with the bank’s EFT software (1½), the only data that the bank requires is the employee code, bank name, employee surname and account details. (1½)

5. Once this has been done, the payroll administrator, Ms N Bossberg, will click on the authorise option (1½) and the head of personnel, Ms V Bothas, will click on the release option. (1½)
  - The release activity cannot be activated before the authorise option. (1½)
6. Additional controls which should be implemented, include the following:
  - Automatic shutdown after three unsuccessful attempts to access the company's bank account on the system. (1½)
  - Logging of unauthorised access attempts (successful attempts will also be automatically logged). (1½)
  - The number of bank accounts to which transfers from the main bank account can take place should be limited to protect the main bank account (1½). Transfers to employees' bank accounts could be scheduled only to take place on specified dates, for example the last day of every month. (1½)
  - A limit on the total amount which can be transferred within a 24-hour period as well as a limit on individual payments can be arranged with the bank. (1½)
  - Data should be encrypted. (1½)
  - Conventional password controls will apply and physical authentication devices, in this case the dongle, must be kept safe and secure at all times. (1½)
7. The EFT will update the employees' masterfile, cash payments journal and deduction accounts. (1½)
 

**(1½ marks for each valid internal control to the maximum of 18 marks)**

### Comment

Did you notice how the information of the scenario was also incorporated in the answer? You should always, where possible, apply the theory to the information provided, thereby indicating you understand the theory, and are not just parroting the textbook.

## OTHER ASSESSMENT METHODS

**KEY TO THE EXAMINATION PAPER INCLUDED IN TUTORIAL LETTER 101/2015 WHICH SERVE AS A SELF-EVALUATION ASSESSMENT.**

### QUESTION 1

**50 marks**

- 1.1 The requirements of sound corporate governance pertaining to the board of directors and board committees** **14 marks**

**Reference:** The King III Report (2009:29–53)

1. M Swart, the **chairman** of the board, is **not an independent non-executive director as required by the King III Report**. (principle 2.16). Speedsew does not comply. (1½)
2. M Swart is the **CEO and chairman** of the board, which is **not** in accordance with principle 2.16 of the King III Report. They do not comply. (1½)
3. The board should comprise a balance of power with a majority of non-executive directors of which the majority should be independent. The board itself, excluding board committees, **has no independent non-executive directors** and does **not** comply with principle 2.18. (1½)

4. The chief executive officer and a finance director should at least be appointed to the board (principle 2.18, point 73). Speedsew **does not have a financial director**. They do not comply. (1½)
5. The company **secretary** should ideally **not be a director** of the company (principle 2.21, point 98). Although the company has no appointed secretary, the chairman (a director) is performing these duties, which is **not in accordance** with the King III Report. They therefore do not comply. (1½)
6. **Appointments** to the board should be a matter for the **board as a whole**, which is in fact the case at Speedsew, and as such **is in terms** of the King III Report (principle 2.19, point 80). They do comply. (1½)
7. The board should be **assisted by the nominations committee when appointing** new directors (principle 2.19, point 80). Speedsew **does apply** this principle. (1½)
8. Speedsew's board **meet six times a year**, which is in **accordance** with the "at least four times a year" requirement of principle 2.1, point 1. (1½)
9. The board should appoint audit, risk, remuneration and nomination committees (principle 2.23, points 129–130). Speedsew **does not have a risk and remuneration committee**. They do not comply. (1½)
10. Speedsew **does not have a company secretary** which is **not** in accordance with principle 2.21, point 95. (1½)
11. **Overall**, the board of directors and board committees do **not** meet the King III Report's requirements for good corporate governance and any recommendations that are not applied should be explained by them. (1½)  
**(1½ marks for each valid point, to the maximum of 14 marks; 18 marks available)**

### Comments

You were required to comment on **both compliance and non-compliance**.

You only need to **identify compliance or non-compliance with brief explanations**; and not the King III Report principle as well. The memorandum includes these for reference purposes. Remember, when answering a corporate governance question, include the theory, application and conclusion with each statement.

### 1.2 Functions of internal audit

**14 marks**

**Reference:** The King III Report (2009:95–98)

FUNCTION NUMBER	YES/NO	BRIEF REASON
1. Assisting the nominations committee: company secretary	Yes (1)	The company secretary is an <b>important appointment in respect of corporate governance</b> . In a sense, the company secretary is similar to internal audit in that both are " <b>control mechanisms</b> ". (1½)
2. Monthly production reconciliations	No (1)	Production reconciliations are <b>routine accounting and production (operational) procedures</b> which should be performed by the production manager and accounting section. (1½)

FUNCTION NUMBER	YES/NO	BRIEF REASON
3. Designing a production costing system	No (1)	The design of systems is an <b>operational responsibility</b> from which the internal audit department should be <b>independent</b> . Internal audit may review the proposed system. (1½)
4. Reviewing compliance with health and safety	Yes (1)	<b>Compliance audits</b> (evaluating whether the company is complying with relevant laws and regulations) are part of internal audit's <b>risk management</b> . (1½)
5. Investigating wage pay-out fraud	Yes (1)	One of internal audit's roles is to provide information regarding <b>instances of fraud</b> or alleged fraud to the board so that appropriate action can be taken. (1½)

(1 mark for each "Yes/No" and 1½ marks for each valid reason to the maximum of 12½ marks)

(1½ marks for correct presentation)

### 1.3 Internal control over the wage packet preparation and pay-out of wages 18 marks

Reference: Jackson & Stent (2015:13/12)

- Wage packets should be **made up by two wage department members**. (1½)
- On delivery of the payroll and pay packets to a section, the section head should ...
  - agree the **number of wage packets to the payroll** (1½)
  - sign the payroll** to acknowledge receipt. (1½)
- The wage packets and payroll should be **locked away until pay-out**. (1½)
- The wage pay-out should be **conducted** by at least **two employees**. (1½)
- Employees should ...
  - present identification** prior to receiving their pay packets (1½)
  - acknowledge receipt of their wage packet by **signing the payroll** (1½)
  - count their cash and **immediately report any discrepancies** to the paymaster. (1½)
- Employees should **not** be allowed to accept a pay packet **on behalf of another employee**. (1½)
- At the conclusion of the pay-out, the paymaster and foreman who have conducted the pay-out, should ...
  - agree all unclaimed **wage packets to the payroll** (1½)
  - enter the details of unclaimed wages in an **unclaimed wage register**. (1½)
- The unclaimed wage packets and payroll should be retained by the paymaster who should **lock them away**. (1½)
- When employees wish to collect their unclaimed wages, they must **identify** themselves and **acknowledge receipt** of their wage packets by signing the unclaimed wage register. (1½)

10. Regular independent **reconciliations** of unclaimed wage packets on hand and the unclaimed wage register should be performed. (1½)
11. Any wages remaining unclaimed **should be banked after two weeks**. (1½)  
**(1½ marks for each valid control to the maximum of 18 marks; 22½ marks available)**

**1.4 Alternative means of payment of wages** **1½ marks**

**References:** Study guide p 97  
 Jackson & Stent (2015:13/24)

1. To protect the company from this risk, as well as for the personal safety of employees, a company could pay wages via **EFT** (1½) directly into employees' bank accounts or via **cheques** (1½) made out in the employee's name.  
**(1½ marks for each valid alternative to the maximum of 1½ marks, 3 marks available)**

**1.5 An example and advantage of biometric data in time keeping** **2½ marks**

**Reference:** Jackson & Stent (2015:13/19)

1. An employee could swipe the identification card of another employee who has not actually come to work, thus creating fictitious hours worked. **The clocking of fictitious hours can be overcome** by employees having to activate the timing device by presenting biometric data (1½). The most common of these is the **thumb or fingerprint** (1).  
**(1½ marks for each valid benefit and 1 mark for each valid example to the maximum of 2½ marks)**

**QUESTION 2** **50 marks**

**2.1 Weaknesses in the system of internal control over credit sales transactions** **20 marks**

<b>WEAKNESS</b>	
<b>Function1:</b>	<p>1.1 The order is not checked against the approved customer list by the order clerk before accepting the order. (1½)</p> <p>1.2 The internal sales order (ISO) is not compared by an independent employee or supervisor to the order to ensure accuracy. (1½)</p> <p>1.3 The order clerk does not sign the ISO to confirm performance of the above. (1½)</p> <p style="text-align: right;"><b>(Limited to two weaknesses)</b></p>
<b>Function 2:</b>	<p>2.1 The credit controller does not perform checks on the order before the ISO is issued. (1½)</p> <p>2.2 The credit controller does not authorise the ISO before sending it to the warehouse. (1½)</p>



<b>WEAKNESS</b>	
<p><b>Function 3:</b></p> <p>3.1 The warehouse clerk does not initial the picking slip for each item picked. (1½)</p> <p>3.2 There is no supervisor or warehouse foreman who performs checks to ensure all goods picked are supported by picking slips. (1½)</p> <p>3.3 The warehouse clerk does not check goods to picking slips before sending it to despatch. (1½)</p> <p>3.4 The warehouse clerk does not prepare delivery notes before sending it to despatch. (1½)</p>	<b>(Limited to two weaknesses)</b>
<p><b>Function 4:</b></p> <p>4.1 The despatch clerk does not compare the goods to the picking slip and delivery note. (1½)</p> <p>4.2 Delivery staff does not supervise the loading of the delivery vehicle. (1½)</p> <p>4.3 There is no security check at the gate where the goods are compared to the delivery note – the vehicle directly leaves for delivery. (1½)</p>	<b>(Limited to two weaknesses)</b>
<p><b>Function 5:</b></p> <p>5.1 On delivery, the customer is not given copies of delivery notes to sign and to retain one copy. (1½)</p> <p>5.2 The invoice is generated before a customer-signed delivery note is received. (1½)</p>	
<p><b>Function 6:</b></p> <p>6.1 The recording of invoices onto the sales journal is not checked by an independent staff member. (1½)</p> <p>6.2 No reconciliation is done between a control total of invoices and the sales journal total before debtor statements are generated and posted. (1½)</p> <p>6.3 No reconciliation is done between the debtors' ledger and the debtors control account in the general ledger before debtor statements are generated and posted. (1½)</p>	<b>(Limited to two weaknesses)</b>

**(1½ marks for each valid weakness to the maximum of 18 marks)**  
**(2 marks for correct presentation)**

## **2.2 Controls over the authorised amendments entered in the debtors' masterfile**

**15 marks**

**Reference:** Jackson & Stent (2015:10/23-10/25)

1. MAFs to be pre-printed sequenced and designed in terms of sound document design principles. (1½)
2. The MAFs should be signed by two senior personnel members after they have agreed the details of the amendment to the supporting documentation. (1½)
3. **Restrict write access to the debtors' masterfile** to a specific member of the section by the use of user identification and passwords. (1½)
4. All masterfile amendments should be **automatically logged by the computer on sequenced logs.** (1½)

5. These sequenced logs should be **reviewed** for accuracy and completeness. (1½)
6. There should be **no write access** to these logs. (1½)
7. To enhance the accuracy and completeness of the keying in of masterfile amendments and to detect invalid conditions, screen **aids and programme checks can be implemented.**(1½)

#### **Screen aids and related features**

8. Minimum keying in of information. (1½)
9. Screen formatting: screen looks like the masterfile amendment form (MAF), screen dialogue. (1½)
10. The account number for a new debtor is **generated by the system.** (1½)

#### **Programme checks**

11. **Verification/matching checks** to validate a debtor account number against the debtors masterfile. (1½)
12. **Alpha numeric** checks on data entered, such as a debtor's company registration number should only use numbers. (1½)
13. **Range and/or limit/data approval checks** on terms and credit limit field. (1½)
14. Field size check and mandatory/missing data checks. (1½)
15. **Sequence check** on MAFs entered to ensure that no MAFs were left out. (1½)
16. **Dependency check**, for example, the credit limit granted may depend upon the credit terms granted, for example, at 90 days up to a limit of R2 000. (1½)
17. The logs should be reviewed regularly by a senior staff member and the sequence of the logs themselves should be checked for any missing logs. (1½)
18. Each logged amendment should be checked to confirm that it is supported by a properly authorised MAF and that the details are correct. (1½)
19. The MAFs themselves should be sequence checked against the log to confirm that all MAFs were entered. (1½)  
(1½ marks for each valid control to the maximum of 15 marks; 28½ marks available)

### **2.3 Physical controls over inventory in the warehouse**

**15 marks**

**Reference:** Jackson & Stent (2015:12/7)

1. There should be **minimum entry and exit points** to the warehouse. (1½)
2. **Entry and exit** to and from the warehouse should be **controlled**, for example swipe cards, keypads, turnstiles, gate control, biometric readers. (1½)
3. **Security guards** should be present at all entry and exit points. (1½)

4. **Entry should be restricted**, for example buying clerks should not be permitted to enter stores unaccompanied. (1½)
5. The **buildings should be secure** with a minimum number of windows and a solid structure. (1½)
6. **Environmental**: areas should be dry, clean, neatly packed, pest free and temperature controlled where necessary. (1½)
7. **Surveillance**/video cameras should be installed over entry and exit points such as receiving and despatch areas. (1½)
8. **Adequate insurance cover** should exist to recover financial losses due to damage to or theft of inventory. (1½)
9. **Fire extinguishers** should be installed in high-risk areas considering the high risk of fire of flammable cleaning materials and chemicals. (1½)
10. Regular **physical inventory counts** should be performed to detect losses in time. (1½)
11. All material **variances** or inventory losses detected during the inventory count should be **investigated**. (1½)  
(1½ marks for each valid control to the maximum of 15 marks; 16½ marks available)