HCM 436
INTERNAL CONTROLS IN HOSPITALITY ADMINISTRATION

Course Team

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INTRODUCTION

The course, Internal Control in Hospitality Administration is a core course which carries two credit units. The course material is prepared for all students who are taking any course in accounting department of the school of management sciences. The course is a useful material to students in their academic pursuit as well as in their workplace as financial managers and administrators.

WHAT YOU WILL LEARN IN THIS COURSE

The course is made up of fourteen units, covering areas such as definitions of internal control, types of internal controls, importance of internal control system, features of internal control system, internal audit, and relationship between internal auditor and the external (independent/statutory) auditor. The course material also covers areas such as assessment and evaluation of internal audit function, audit of internal control system, and problems of internal control system. The last part of the course material covers internal control of stock in hotel management, cash disbursement control in hotel management, petty cash control in hotel management, account receivables control in hospitality administration, and control of employees’ remuneration in hospitality administration.

COURSE AIMS

The aim of the course is to expose you to the meaning and assessment of internal control system. The course also aims at pointing out techniques of evaluating internal audit function that are needed for control of stock, cash disbursement, petty cash, account receivables and employees’ remuneration. The aim of the course will be achieved by:

1. defining the term ‘internal control’
2. explaining the types of internal control
3. mentioning the features and importance of internal control system
4. stating the relationship between internal auditors and external auditors
5. explaining internal audit
6. discussing ways of assessing and evaluating internal audit function
7. describing internal control of stock in hotel management
8. explaining internal control of cash disbursement, petty cash and account receivables
9. describing the control of employees’ remuneration in hospitality administration.
COURSE OBJECTIVES

After completing this course, you should be able to:

- define internal control
- state the types of internal control
- list the features and importance of internal control system
- state and explain the relationship between internal auditors and external auditors
- explain internal audit
- state and discuss the ways of assessing and evaluating internal audit function
- describe internal control of stock in hotel management
- discuss the concepts of internal control of cash disbursement, petty cash and account receivables
- explain the control of employees’ remuneration in hospitality administration
- discuss the limitations of internal control systems
- discuss the factors consider before placing reliance on the work of internal auditors
- state eight areas of cooperation between internal and external auditors.

WORKING THROUGH THE COURSE

The course consists of the definition of internal control, the importance of internal control system, features of internal control system, and internal audit. The course highlights the relationship between internal auditor and the external (independent/statutory) auditor. The course also examines the assessment and evaluation of the internal control system in hospitality administration.

The techniques of recording in hospitality administration are also highlighted in this course as well as the problems of internal control system in hospitality administration.

Lastly, the course highlights the internal control of major and important aspects of hospitality administration: stock; cash disbursement; petty cash; account receivables; and employees’ remuneration.
COURSE MATERIALS

The major components for the course are:

(a) Course Guide
(b) Study Units
(c) Textbooks
(d) Assignment Guide

STUDY UNITS

There are fourteen units in this course which should be studied carefully. They are as follows:

Module 1

Unit 1 Definitions of Internal Control
Unit 2 Types of Internal Control
Unit 3 Importance of Internal Control System
Unit 4 General Features of Internal Control System

Module 2

Unit 1 Internal Audit
Unit 2 Relationship between Internal Auditor and the Independent Auditor
Unit 3 Assessment and Evaluation of the Internal Control System in Hospitality Administration
Unit 4 Techniques of Recording in Hospitality Administration
Unit 5 Problems of Internal Control System in Hospitality Administration

Module 3

Unit 1 Internal Control of Stock in Hospitality Administration
Unit 2 Cash Disbursement Control in Hospitality Administration
Unit 3 Petty Cash Control in Hospitality Administration
Unit 4 Account Receivables Control in Hospitality Administration
Unit 5 Control of Employees’ Remuneration in Hospitality Administration

The first module defines internal control, explains the types of internal control, the importance of internal control system and the general features of internal control system.
The second module defines internal audit, states the relationship between internal auditor and the independent auditor, describes the assessment and evaluation of the internal control system in hospitality administration, explains the techniques of recording in hospitality administration and highlights the problems of internal control system in hospitality administration.

The third module (last five units) describes the internal control of stock, cash disbursement, petty cash, account receivables and control of employees’ remuneration in hospitality administration.

**THE ASSIGNMENT FILE**

There are self test questions as assignment in this course and you are expected to do all of them and submit for grading by your tutor.

**ASSESSMENT**

There are two aspects to the assessment of the course. The first are the tutor-marked assignments and second there is a written examination.

You are advised to be sincere in attempting the exercise. In tackling the assignments, you are expected to apply information, knowledge and techniques gathered during the course.

The assignments must be submitted to your tutor for formal assessments in accordance with the deadlines stated in the presentation schedule and the assignment file. The work you submit to your tutor for assessment will count for 30% of your total course mark. At the end of the course you will need to sit for a final examination of about three hours duration. This examination will count 70% of your total course mark.

**TUTOR-MARKED ASSIGNMENT**

In doing the tutor-marked assignment, you are to apply your knowledge and what you have learnt in the contents of the study units. These self test questions which are ten in number are expected to be turned in to your tutor for grading. They constitute 30% of the total score for the course.

**FINAL EXAMINATION AND GRADING**

At the end of the course, you will write the final examination. It will attract the remaining 70%. This makes the total final score to be 100%.
PRESENTATION SCHEDULE

The dates for submission of all assignments will be communicated to you. You will also be told the date of completing the study units and dates for examinations.

HOW TO GET THE MOST FROM THIS COURSE

In distance learning, the study units replace the university lecture.

This is one of the great advantages of distance learning: you can read and work through specially designed study materials at your own pace, and at a time and place that suit you best. Think of it as reading the lecture instead of listening to the lecturer. In the same way a lecturer might give you some reading to do, the study units tell you where to read, and which are your text materials or set books. You are provided exercises to do at appropriate points, just as a lecturer might give you an in-class exercise. Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit, and how a particular unit is integrated with the other units and the course as a whole. Next to this is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. These learning objectives are meant to guide your study. The moment a unit is finished, you must go back and check whether you have achieved the objectives. If you make this a habit, then you will significantly improve your chances of passing the course. The main body of the unit guides you through the required reading from other sources. This will usually be either from your set books or from a reading section. The following is a practical strategy for working through the course. If you run into any trouble, telephone your tutor.

1. Read this Course Guide thoroughly, it is your first assignment.

2. Organise a study schedule. Design a ‘course overview’ to guide you through the course. Note the time you are expected to spend on each unit and how the assignments relate to the units. Whatever method you choose to use, you should decide on and write in your own dates and schedule of work for each unit.

3. Once you have created your own study schedule, do everything to stay faithful to it. The major reason why students fail is that they get behind with their course work if you get into difficulties with your schedule, please, let your tutor know before it is too
late to help. Turn to unit 1, and read the introduction and the objectives for the unit.

4. Assemble the study materials. You will need your set books and the unit you are studying at any point in time. As you work through the unit, you will know what sources to consult for further information.

5. Keep in touch with your study centre. Up-to-date course information will be continuously available there.

6. Well before the relevant due dates (about 4 weeks before due dates), keep in mind that you will learn a lot by doing the assignment carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the examination. Submit all assignments not later than the due date.

7. Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study materials or consult your tutor.

8. When you are confident that you have achieved a unit’s objectives, you can start on the next unit. Proceed unit by unit through the course and try to pace your study so that you keep yourself on schedule.

9. When you have submitted an assignment to your tutor for marking, do not wait for its return before starting on the next unit. Keep to your schedule. When the assignment is returned, pay particular attention to your tutor’s comments, both on the tutor-marked assignment form and also the written comments on the assignments.

10. After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in the Course Guide).

FACILITATORS/TUTORS AND TUTORIALS

Information relating to the tutorials will be provided at the appropriate time. Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter and provide assistance to you during the course.
You must take your tutor-marked assignments to the study centre well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible. Do not hesitate to contact your tutor if you need help. Contact your tutor if:

i. You do not understand any part of the study units or the assigned readings
ii. You have difficulty with the exercises
iii. You have a question or problem with an assignment or with your tutor’s comments on an assignment or with the grading of an assignment.

SUMMARY

The course Internal Control in Hospitality Administration exposes you to the concepts of internal control (definitions, types, importance and features), internal audit and techniques used in internal control system by both internal auditors and independent auditors on stock, cash disbursement, petty cash, account receivables and employees’ remuneration. On successful completion of this course, you should have been armed with the materials necessary for efficient and effective internal control system for safeguarding the profits of hospitality administration and management of proper books of records in hospitality administration.
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Welcome to this course on Internal Control. This course is designed to help business owners and operators understand the need for internal controls and develop simple systems that can be put in place in their businesses to safeguard the firm’s valuable assets, amongst other ends.

Whether a business is a sole trader or has many employees, introducing internal controls will ensure that the business runs more efficiently, resources are not lost and there are fewer unpleasant surprises.

Organisations, especially small businesses, are the most vulnerable to fraud, because they often do not have effective internal controls. You could also paralyse your business trying to cover every possible contingency. However, by removing opportunity and motivation for fraud and theft, and ensuring you have systems in place to discourage errors and identify mistakes and anomalies quickly, you are able to discourage fraud in the first place and, if that fails, you can take corrective action to minimise losses.

Furthermore, good internal controls help you manage resources and make sure operations are efficient and effective. Owners/managers of
businesses hold the key to the fight against internal control failures and must be attentive to the concept and issues of internal controls to maximise the business potential and minimise the risk of fraud, error and loss.

Thus, this course has been designed primarily to develop your awareness of a good internal control system and the techniques used to minimise the risk of fraud, error and loss.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define the term internal control
- outline the points to note in internal control definition
- list the major objectives internal control is designed to achieve.

3.0 MAIN CONTENT

3.1 Definition of Internal Control

It is salient to state that every organisation, irrespective of whether it has been set up to pursue profit or not, regardless of its nature of business and operations, across various industries and sectors or geographical areas of operations, has certain unifying objectives with respect to financial reporting. The attainment of these objectives, by and large, tends to drive the entity’s processes and procedures towards the achievement of survival, growth and profitability goals. These objectives are as follows:

- Safeguard of valuable assets and resources
- Deter and detect errors, fraud and theft
- Ensure effective and efficient running of its operations
- Ensure the accuracy and completeness of its accounting data
- Produce reliable and timely financial and management information and
- Ensure adherence to its policies and plans.

It is instructive to mention that any measure, process or structure, whether proactively or reactively designed and implemented, to ensure the realisation of the afore-stated objectives, can loosely be referred to as “control”. Put differently, control could be regarded as steps or actions taken, measures instituted to ensure that nothing goes awry in an
organisation that will make the entity suffer operational, and by extension, financial losses.

The following illustrations will bring the concept of “control” closer home. One classical example of a control is ensuring that the work of subordinate is reviewed by a superior officer to reduce incidences of errors. Another instance of a control is having in place, a policy which requires keeping all the cash in hand, beyond a particular sum, say N200,000, at the close of business in a fire-proof vault, access to which can only be gained by two or more different officers (otherwise called “dual access control”). This second example of control could be made robust by requiring that, in the event that the cash in hand exceeds N200,000, such cash must be banked that day. Of note is the fact that the overriding objective of putting in place these measures is to prevent theft of cash or reduce its incidences.

Building on your understanding on what a control is, it is right at this point to define internal control system, a concept derived from control but with broader scope. Internal control system is concerned with the control operative in every areas of corporate activity. According to auditing practices committee, it can also be defined as “the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets, and secure, as far as possible, the completeness and accuracy of the financial records”.

It is therefore vital to note that controls are not designed for any cause. Rather, they are instituted to achieve certain means or provide the framework for achieving these means.

### 3.2 Points to Note in Definitions of Internal Control

The individual components of an internal control system are known as controls. The important points to note in this definition are as follows:

1. The internal control system is established by management.
2. They are designed to achieve four major objectives which are:
   a. To enable management carry on the business in an orderly and efficient manner.
   b. To ensure that management policies are adhered to throughout the organisation.
   c. To ensure that proper custody is maintained over the valuable assets of the enterprise.
d. To ensure that all authorised information is recorded accurately and correctly.

e. These objectives are better appreciated through lucid explanations of the following key facets viz: orderly management of business; adherence to policies; proper custody of valuable assets and authorisation of information.

- **Orderly and Efficient Management of the Business**

A well-established and well-run organisation is one with clear structure and processes on how tasks are to be carried out, who to do what, when these tasks are to start and the expected completion time, and whose duties it is, to ensure that these tasks are well carried out. Suffice to add that an organisation with a disorderly working environment will imprudently manage its resources, with attendant consequences of wastages, theft, frauds, low profitability, stunted growth and accounting records replete with errors. To avoid these negative ends, a robust internal control system can help to ensure orderly and efficient running of an organisation.

- **Adherence to Management Policies**

Policies are supposed to guide the actions and activities of management and staff alike. When policies are formulated and not followed by the rank and file of an organisation, its consequences, financial or operational, could be dire and grave. Hence, internal control system helps to ensure that whatever blueprint that management has designed to guide operations, actions, conducts and activities are followed. A case in point is when an organisation puts in place a policy on action time to attend to email, say 5 minutes. When an employee receives a vital mail requiring prompt action from an important client and he fails to act on it as required by the policy, it may spell severe consequences for the organisation as a whole.

- **Maintenance of Proper Custody over Valuable Asset**

An organisation that fails or is negligent in adequately protecting its valuable assets is as good as “dead”, as this may encourage pilferage, theft, fraud of different shades and proportion, with attendant colossal financial losses.

- **Completeness and Accuracy of Financial Records**

Vital decisions, be it internal or external, are made about an organisation on the basis of financial statements or accounts prepared from certain
underlying accounting records. Accordingly, it is noteworthy to state that where these underlying accounting records are riddled with errors, irregularities and fraud, misleading decisions are bound to be taken. Internal control system therefore, seeks to ensure that organisation records are, to all intent and purposes, properly kept and largely devoid of errors.

### 3.3 Who Is In Control?

Management is responsible for internal controls. Walking through the five components of control explains why.

a) Management has the most influence on the control environment for a department.

b) Management sets business objectives; it also helps employees understand the objectives, and can encourage employees to discuss the risks in achieving them.

c) Management establishes the activities needed to ensure everyone is carrying out its directives in accordance with existing laid down rules, regulation and policies.

d) Management is responsible for facilitating communications and information flow within a department.

e) Finally, management provides day-to-day supervision.

Thus, if management buys into the committee of sponsoring organisations of the Treadway commission (COSO) definition, they should also buy into the idea that controls are one of their key responsibilities.

Auditors can facilitate this buy-in by explaining to management what internal control means and focusing in COSO’s role as a “framework” that embraces many other controls and management mechanisms.

Auditors should also explain that controls exist to help achieve basic objectives, like serving the customers, selling goods, and protecting assets.

Finally, internal auditors need to fully understand that management and employees working in an area are the “experts” in the business of that area and will always know more about what goes on than the internal auditors who periodically visit it. If internal controls are truly effective, all the five components of the COSO framework must be working, even when the auditors are not working.
4.0 CONCLUSION

In this unit, it is believed that you have learnt about the term ‘control’, ‘internal control’, important points to note when defining these key concepts and the objectives for which internal control system is designed to achieve.

5.0 SUMMARY

Any measure designed to ensure, amongst other things, that an organisation affairs run smoothly can be regarded as “control”. One classical example of a control is ensuring that the work of subordinate is reviewed by a superior officer to reduce incidences of errors.

The totality of these controls and how they interact is regarded as internal control system. It could also be conceptualised as the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the financial records. From this definition stemmed the fact that they are established by management to, inter alia, ensure that the organisation’s business is carried out in an orderly and efficient manner.

Finally, management is unquestionably in charge of internal control system. This position is justified by the following factors:

- They have the most influence on the control environment
- They set up business objectives
- Management set up activities geared towards achieving the set business objectives
- They facilitates communication and information flow within the organisation
- Management provides day to day supervision of the business.

6.0 TUTOR-MARKED ASSIGNMENT

i. Define the term ‘internal control’?
ii. Itemised the objectives of putting in place a good internal control system.
7.0 REFERENCES/FURTHER READING


UNIT 2 TYPES OF INTERNAL CONTROL

CONTENTS

1.0 Introduction
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1.0 INTRODUCTION

The internal control of assets (and liabilities) in any organisation should be carefully instituted and dispassionately implemented to reduce fraud, amongst other goals. The internal control should cover control of valuable assets, objectivity in recording financial transactions, ensuring integrity on the part of the recording personnel, supervision control, authorisation of records and activities should be acknowledged by means of signatures, initials, rubber stamp etc.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the acronym for types of internal control
- explain each letter of the acronym
- list other categories of internal control
- explain the other types listed.

3.0 MAIN CONTENT

3.1 Types of Internal Controls

Management may decide on any type of suitable internal control(s) for the organisation. According to the guidelines issued by the Institute of Chartered Accountants of England and Wales (ICAEW) on internal control, the types of internal control are mnemonically put as ‘PAPAMOSS’. The Acronym is a list of some of the types of controls
that may be found in many enterprises. The meaning of the acronym ‘PAPAMOSS’ is highlighted below:

a. ‘P’ Physical Controls over Assets
b. ‘A’ Arithmetical and Accounting Controls
c. ‘P’ Personnel Controls
d. ‘A’ Authorisations and Approvals
e. ‘M’ Management Controls
f. ‘O’ Organisational Controls
g. ‘S’ Segregation of Duties
h. ‘S’ Supervisory Controls

a. ‘P’ Physical Controls over Assets: These are those procedures and measures set up to secure proper custody over valuable corporate assets. They prevent unauthorised access to these assets. All assets of an organisation should be safeguarded at all times especially the valuable and portable assets such as cash, stock and motor vehicle. Security of assets should be designed to ensure that access to assets is limited to authorised persons and no asset is stolen without notice.

Examples include: keeping cash in the vault with dual access control; taken measures that will ensure that official vehicles are used for only official engagements, hiring security personnel to guard office premises, restricting access to some sensitive areas in an organisation, the use of passwords, to cite just a few.

b. 'A' Arithmetical and Accounting Controls: These controls, which are predominant in the recording function, ensure that all transactions occurring during the period have been authorised, and that they have all been correctly and accurately recorded and processed. There should be a system of checks on the arithmetic accuracy of the accounts kept in respect of transactions e.g. extraction of balances, to check the accuracy of all postings during a given period, establishment of control accounts of creditors and debtors and the preparation of bank reconciliation statement etc. This example also includes checking the arithmetical and accuracy of calculations and maintaining and checking control totals.

c. ‘P’ Personnel Controls: No matter how well a system is designed, its efficient and effective functioning will depend on the operators. Controls are therefore necessary to ensure that personnel have capabilities commensurate with their responsibilities. These controls, known as personnel controls,
provide a framework for ensuring an efficient selection and training procedure for staff. There should be qualification system to ensure that a capable staff is allocated to a particular duty and is sufficiently motivated to ensure effective and efficient performance of his duty with complete integrity.

d. ‘A’ Authorisations and Approvals: These are those controls, which specify the persons responsible for authorising and approving transactions and the limits of such authority. All transactions should be authorised and approved by responsible officials before the organisation is financially committed. Such authority should be clearly specified in writing and the limit of authority or responsibility clearly defined.

For instance, an organisation may have an authorisation and approval policy that requires that any transaction between N10 million and N20 million can be authorised and approved by a manager; while transactions with sums above N20 million but less than N50 million can be approved by a senior manager with the managing director having an approval limit above N50 million but less than N100 million.

e. ‘M’ Management Controls: These are those controls characteristically executed by top management on a periodic basis as against a daily basis. Conceivably, they include periodic reviews of management accounts and comparison thereof with budgets and other special reviews. Some writers call management controls overriding controls. It is the responsibility of management to establish control for day-to-day operation of the affairs of the organisation and this will include supervisor controls, internal audit functions, review of management accounts and comparison of actual result with budget and other review procedures.

f. ‘O’ Organisational Controls: These are those controls, rules, regulations and procedures which:

- Specify the organisational plan (structure)
- Define roles and allocates responsibilities
- Identifying lines of reporting for all aspects of the enterprises’ operations.

Responsibilities should be allocated to staff according to experience and proficiency and the line of reporting should be
clearly indicated. It is of importance that an organisation has an organisational chart showing unmistakably all lines of reporting.

g. **‘S’ Segregation of Duties:** They are those controls, which ensure that separate individuals or groups of individuals carry out the main functions of an organisation of authorisation, executive, custody and recording. It is believed that the separation of these critical duties will minimise the inherent risk of fraud or errors and increase the element of checking within the system. This is to ensure that no one person is responsible for all aspects of a transaction. In other words, the job should be arranged in such a way that the work of one person is complementary to that of another or independently checked by another person so that fraud and error may be minimised or early detection benefit maximised. Involvement of more individuals reduces the risk of accidental error and deliberate fraud.

Examples include separating the work of a staff whose duty it is to collect cash from customer from the work of a staff that is saddled with the task of recording the amount collected, backed with evidence. Also, these two tasks should be separated from the work of the staff that is expected to bank the cash collected. The purpose of this, as much as possible, is to discourage or make collision difficult, if not outright impossible.

h. **‘S’ Supervisory Controls:** These are controls over day-to-day activities of the organisation, which ensure that the work of less experienced staff are reviewed and controlled by independent, more senior and experienced staff. This is part of the internal check. The checker should have a thorough knowledge of the job.

### 3.2 Other Categories/Types of Internal Control

In addition to the above controls (PAPAMOSS), the other categories are:

i. **Acknowledgement of performance:** This is the control that specifies that for each activity performed, the person that performs the activity must acknowledge in writing that he performed the activity. The level of acknowledgement varies from simply signing-off with date or doing it with brief comment on the activity carried out. It is expected that somebody will not acknowledge a performance he is not sure of. Persons performing data processing operations should acknowledge their activities by means of signatures, initials, rubber stamp etc.
For example, if invoice calculations have to be checked, the checker should initial each invoice. Acknowledgement of performance not only allows blame to be ascribed but also has a powerful psychological effect. Audit clerks usually initial the audit programme when they have completed part of the work. Even audit clerks reluctantly confirm in writing that they have examined a thousand credit notes when they looked at only one hundred.

ii. **Budgeting Controls:** These are controls that set targets for activities, volumes and other financials of the organisation. Targets are set for the number of new customers for the marketers, for expenses, sales, production, stock levels, purchases, fixed assets acquisition etc. These targets act as goal motivation for the employees. They also form reasonable basis for assessing staff efforts. A common control technique applied in business is the use of budgets, which can be defined as a quantitative plan of action. Budgets, having been agreed, can be compared with actual performance and differences investigated.

### 3.3 Inherent Limitations

No internal control system, however elaborate, can buy itself guarantee efficient administration, completeness and accuracy of records. This is so because of the following reasons:

(i) Two or more dishonest persons working in collusion can override the efficacy of the best possible controls

(ii) Authorisation controls can be abused by those in whom the authority is vested

(iii) Management is in a position to override controls set-up by it. To override a control means to set it aside and not used it for the purpose for which it is meant. An example includes a managing director approving transactions with sums higher than its approval limit(an amount which is supposed to be approved by the board of directors) either to suit selfish interests or on expediency ground, just to avail the organisation the opportunity to catch up with seemingly profitable opportunities

(iv) Pressure exerted from within and outside the organisation can influence the integrity and competence of staff. For instance, an employee that is under peer pressure to buy latest automobiles, build mansions, send his children to Ivy-league schools may be pushed to indulge in sharp practices in order to achieve these ends
(v) Human errors due to errors of judgment and interpretation, misunderstanding, carelessness, fatigue or distraction can undermine the effective operation of internal controls

(vi) Abuse of responsibility

(vii) A requirement that the cost of an internal control is not disproportionate to the potential loss which may result from its absence. This can otherwise be referred as cost-benefit of the internal control. For instance, it does make any economic sense for an organisation that keeps low level of cash every day, say =N=5,000, to venture into buying a fire and theft proof cash vault worth =N=10 million. Clearly, the cost of buying the vault with a view to protecting a meager cash balance outweighs the benefit of protecting the cash

(viii) Changes in environment that is capable of making controls inadequate, if not outright redundant.

Because of these inherent limitations in even the most effective internal control system, it will not be possible for the auditor to rely solely on its Operations as a basis for his opinion on the financial statements or process. In some organisations, the auditor may be unable to determine whether all the transactions have been reflected in the accounting records unless there are effective internal controls.

3.4 Components/ Process of Internal Control

Internal control consists of five inter-related components or activities.

There are five steps, or components, in the Committee of Sponsoring Organisations of the Treadway Commission (COSO) internal control framework, all of which are management’s responsibility to perform.

These internal control components are presented as a pyramid, with control environment as the base, risk assessment and control activities the next levels up, information and communication near the top, and monitoring at the peak.
3.4.1 Control Environment

It is the framework within which other controls operate. The control environment contains informal, and often intangible, soft controls, such as ethics, integrity, management philosophy, and commitment to competence, as well as more formal controls like organisational structure and assignment of roles and responsibilities. The control environment consists of those factors that set the tone of an organisation and thereby influence the control consciousness of people in the organisation. The factors which influence control environment, some have been mentioned above, include the followings:

(i) Integrity and ethical values
(ii) Commitment to competence
(iii) Board of directors’ or audit committees’ activities
(iv) Management’s philosophy and operating style
(v) Organisational structure
(vi) Assignment of authority and responsibility
(vii) Human resources policies and practices.

These factors are explained below:

(i) \textbf{Integrity and Ethical Values}

These are essential elements which influence the effectiveness of the design, administration and the monitoring of controls. A good example is an organisation having a clear, effectively communicated and well enforced code of conducts, statements of core values et cetera for its entire staff, including management staff. This greatly shapes the organisational culture and strengthens its behavioural capabilities.
It is indeed again apt to illustrate these elements using the core values of a reputable international consulting firm, KPMG. One of the values of this firm reads: “above all, act with integrity”, meaning that no matter the circumstances, however justified it may appear, KPMG staff are expected to be above-board in terms of professional conduct and integrity. It is instructive to add that these core values are well-enforced throughout the firm, especially in its professional relationships with clients, amongst

Commitment to Competence

This relates to management’s consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

(ii) Board of Directors’ and Audit Committees’ Activities

This involves independence of the members of the board from management, their experience and stature, the extent of their involvement and scrutiny, the information which they receive, the degree to which difficult questions are raised and pursued with management and their interaction with internal and external and external auditors.

(iii) Management Philosophy and Operating Style

This explains management’s approach to taking and managing business risk and managing attitudes and actions towards financial reporting, information processing and accounting functions and personnel.

(iv) Organisational Structure

This represents the framework within which an entity’s activities for achieving its objectives are planned, executed, controlled and reviewed. A good structure is one with clear reporting lines and which also facilitates effective two-way kind of communication throughout the organisation.

(v) Assignment of Authority and Responsibility

Authorities and responsibilities for operating activities must be properly assigned. Reporting and authorisation hierarchies are established; this is where clear job descriptions (JDs) and job manuals (JMs) for staff come in. At every point in time and on
every working day, staff are expected to know their roles and responsibilities within the organisation geared toward achieving set goals and objectives.

(vi) **Human Resource Policies and Practices**

This addresses recruitment, orientation, training, evaluating, counseling, promoting, compensating and remedial actions for staff.

It is noteworthy to state that these elements help set the general tone of internal control. When the tone is good, it is then other workable controls can be built.

The control environment is the foundation for the other components of internal controls, providing discipline and structure. All of the other components of control depend on the solidity of this base. It provides an atmosphere in which people conduct their activities and carry out their control responsibilities.

It is imperative to add that a strong control environment does not, by itself, ensure the effectiveness of the overall internal control system, but can be a positive factor when assessing business risks. A weak internal control system, conversely, can undermine the effectiveness of other controls.
3.4.2 Risk Assessment

Management sets both entity-wide objectives and activity objectives, identifying and analysing the risks that these objectives will not be achieved. All entities, regardless of size, structure, nature or industry are subject to business risk. Business risks affect each entity’s ability to survive, compete successfully within its industry, maintain its financial strength and positive public image and safeguard the overall quality of its products, services and well being of its people.

The decision to be in business is a decision to accept risk. There is no practical way to reduce risk to zero. Management and the board of directors decide the risks to be accepted and the extent and methods to be applied to monitor and mitigate the risks. Because economic, industry, regulatory and operating conditions continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

During a risk assessment, management identifies and analyses risks that pose threats to the achievement of its objectives and form a basis for determining how the risks should be managed. Management should have identified and initiated measures to mitigate the important risks, based on their probability and impact, before the auditors begin an audit. The auditors should then evaluate the risk assessment process.

Risk assessment also involves analysing, profiling and consolidating risks. It can be said to also extend to how an organisation responds to risk in terms of strategies. Typically, an organisation responds to risk using four strategies of risk avoidance, risk reduction, risk acceptance and risk transfer. These strategic risk assessment measures are best illustrated using the consequences-likelihood framework as given below:

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>(High)</td>
<td>(Low)</td>
</tr>
<tr>
<td>*Accept</td>
<td>Risks are not significant. Keep under view but cost of dealing with risks unlikely to be worth the benefits.</td>
</tr>
<tr>
<td>*Transfer</td>
<td>Insure risk or implement contingency plans. Reduction of severity of risk will minimise insurance premiums.</td>
</tr>
<tr>
<td><strong>Reduce</strong></td>
<td><strong>Avoid</strong></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Take some actions, e.g. Self-insurance to deal with frequency of losses.</td>
<td>Take immediate action to reduce severity and frequency of losses, e.g. charging higher prices to customers or ultimately abandoning activities</td>
</tr>
</tbody>
</table>

(Source: BPP ACCA Study Kits, 2013)

### 3.4.3 Control Activities

The mechanisms established by management to ensure that their directives are carried out, including the activities identified to mitigate risks, are control activities. Put differently, they are those policies and procedures, in addition to the control environment, which are established to achieve the entity’s specific objectives. These controls depend greatly on the activity under consideration. A great deal of activity-specific knowledge is required to determine what the controls should be. COSO’s control framework presents a risk control matrix that analyses activity-level objectives, risks and controls. This matrix is but one method of establishing control activities. Other methods or ways of establishing control activities includes:

a) Flow charting  
b) Analysing the completeness, accuracy, authorisation, timeliness of transactions  
c) Safeguarding of the input, processing, and output (IPO) of transactions  
d) Strength, weaknesses, opportunities and threats (SWOT) analysis.

Examples of control activities are:

- Approval and control of documents  
- Controls over computerised applications  
- Checking the arithmetical accuracy of records  
- Maintaining and reviewing control accounts and trial balances  
- Reconciliations of accounts and records  
- Limiting physical access to assets and records.

### 3.4.4 Information System

This involves how the information system captures events and conditions, financial reporting process, related accounting records,
whether electronic or manual system is used to support the reporting process, the procedures within both information technology methods and manual systems by which those transactions are initiated, recorded, processed and reported in the accounts. It can also be referred to as information and communication. This aspect of the framework requires constant communication amongst the various stakeholders regarding how to make the control system robust and goal-centric. It also serves as the oil that lubricates the wheel of this all-important internal control model.

3.4.5 Monitoring of Controls

The role of monitoring of controls in ensuring the continued effectiveness of internal control system cannot be over-emphasised. From the control environment to the information system, all of these components have to be continuously reviewed with a view to ensuring that are working the way they should. A once robust internal control system can grow very weak if the risks for which it was instituted are no longer there, or have been rendered outdated by advancement in technology or changes in the organisation.

Furthermore, monitoring leads to the timely identification and correction of control deficiencies before they materially affect the achievement of the organisational objectives. It also ensures that internal controls continue to operate effectively.

(Source: COSO internal control framework, 2013)

The process involves the assessment by appropriate personnel of the design and operations of control on a suitably timely basis, and the taking of necessary action. The processes involved in monitoring of controls are as diagrammatically depicted below:
(Source: COSO integrated internal control framework, 2013)

4.0 CONCLUSION

Internal control in an organisation should include physical control over assets, arithmetic and accounting control, personnel control, authorisation and approval control, management control, organisation control, segregation of duties, supervisory control, acknowledgement of performance and budgeting. It is therefore important for organisations to understand these controls very well in the light of their expectations and take pragmatic efforts to ensure proper documentation.

5.0 SUMMARY

Internal control types are mnemonically expressed as “PAPAMOSS”. The meaning of this mnemonic is highlighted below:

‘P’ Physical Controls over Assets
‘A’ Arithmetical and Accounting Controls
‘P’ Personnel Controls
‘A’ Authorisations and Approvals
‘M’ Management Controls
‘O’ Organisational Controls
‘S’ Segregation of Duties
‘S’ Supervisory Controls

Other categories/types of internal control include: acknowledgement of performance and budgeting controls.

Furthermore, a sound internal control system is typically undermined by collusion between two or more people with the intention to override
controls, human errors, prohibitive cost of design, especially if this outweighs anticipated benefits, to mention but a few.

Characteristically, a complete internal control system comprises control environment, risk assessment process, control activities, information system and control monitoring of controls. These components are as defined in the Committee of Sponsoring Organisation (COSO) of the Treadway Commission’s integrated framework for internal controls.

While control environment consists of those factors that help to set the tone of an organisation which influences the control consciousness of people in the organisation, risk assessment process, another vital component of internal control system, provides a framework for identifying, evaluating and responding to business risks to which an organisation is exposed, and in respect of which controls are instituted.

Control activities are policies and procedures established by management to ensure its directives are carried out. Examples of control include limiting physical access to valuable assets and records. Information system, whereas, explains how events and conditions are captured and essential information passed from one element of the system to another, both internally and externally. Lastly, monitoring helps to keep a tab on other four components of the system, ensuring they work as seamless, as effective and as efficient as possible.

6.0 TUTOR-MARKED ASSIGNMENT

i. Write in full the acronym “PAPAMOSS”.
ii. Explain the types of internal control you know.
iii. Mention other types of internal control apart from ‘PAPAMOSS’

7.0 REFERENCES/FURTHER READING


UNIT 3  IMPORTANCE OF INTERNAL CONTROL SYSTEM

CONTENTS

1.0   Introduction
2.0   Objectives
3.0   Main Content
   3.1  Highlights of Importance of Internal Control System
   3.2  Explanation of Highlighted Importance
4.0   Conclusion
5.0   Summary
6.0   Tutor-Marked Assignment
7.0   References/Further Reading

1.0  INTRODUCTION

Losses through fraud and embezzlement by associates and employees at all levels - property, corporate and ownership levels - contribute to cost pressures in an organisation. It is therefore compulsory for organisations to carry out effective and efficient internal control in an organisation when the importance is considered.

2.0  OBJECTIVES

At the end of this unit, you should be able to:

- highlight the importance of internal control system
- explain the importance highlighted.

3.0  MAIN CONTENT

3.1  Highlights Of Importance Of Internal Control System

The following is a highlight of the importance of internal control system. The importance is highlighted below

(i)  Management of risks
(ii) Report facilitation
(iii) Effective financial control
(iv) Risk control.
3.2 Explanation of Highlighted Importance

i. Management of Risks

An organisation’s system of internal control has a key role to play in the management of risks that are significant to the fulfillment of its business objective. A sound system of internal control contributes to safeguarding the shareholders' investment and the company’s assets.

ii. Report Facilitation

It facilitates the efficiency and effectiveness of internal and external reporting, and assets compliance with laws and regulations.

iii. Effective Financial Control

Effective financial controls (including the maintenance of proper accounting records) are an important element of internal control. They help to ensure that the organisation is not unnecessarily exposed to avoidable financial risks and the financial information used within the business and for external publications is reliable. They also contribute to the safeguarding of assets, including the prevention and detection of fraud.

iv. Risk Control

An organisation’s objective, its internal structure and the environment in which it operates are continually evolving and as a result, the risks it faces are continually changing. A sound system of internal control therefore depends on a thorough and regular evaluation of the nature and extent of the risks to which the organisation is exposed. Since profits are in part, the reward for successful risk taking in business, the purpose of internal control is to help manage and control risk appropriately rather than to eliminate it.

4.0 CONCLUSION

Internal control system contributes to safeguarding the shareholders' investment and the company’s assets, ensures assets compliance with laws and regulations, maintenance of proper accounting records, and managing and controlling of risk appropriately rather than to eliminate.
it. It is necessary you know this in order to know the essence for which internal control system should be designed.

5.0 SUMMARY

The importance of a robust internal control system cannot be stressed enough, as it helps in the management of risk, facilitate timely reporting, whether internal or external, fosters effective financial control and also helps to control risk. These benefits of internal control system, especially a robust one, ensure that shareholders’ investments are adequately safeguarded, laws and regulations complied with and accounting records properly maintained.

6.0 TUTOR-MARKED ASSIGNMENT

i. Highlight the importance of internal control system.

ii. Explain the points highlighted in question one.

7.0 REFERENCES/FURTHER READING


UNIT 4 FEATURES OF INTERNAL CONTROL SYSTEM

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Factors Determining Internal Control System
   3.2 Features of Internal Control System
   3.3 Internal Control and Statutory Audit
   3.4 Reports to Management on Internal Control Systems
   3.5 Internal Check
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

The nature of the control operating within any commercial organisation is determined, amongst other things, by the organisational structure as well as the size of the organisation. This unit is designed to enable you to know the characteristics of a good internal control system. It is designed to make you know those necessary things that must be featured in a good internal control system before you can adequately carry out internal control in an organisation.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain factors determining internal control system
- explain features of internal control system
- explain the relationship between internal control and statutory audit
- recognise content of management reports on internal control conducted
- write what internal check is and what it includes.
3.0 MAIN CONTENT

3.1 Factors Determining Internal Control System

One basic feature that is common to all internal control systems is the separation of duties. The principle ensures that the three basic functions of authorisation, custody and recording are given to different people to avoid a situation where a single person can process a transaction from the initiation stage to the recording stage.

A good organisation structure should be evidenced by organisational charts and written job descriptions showing authorities, duties and lines of reporting. For a good audit practice the auditor should obtain a copy of all organisational charts so to familiarise him with the level of authority and lines of reporting existing in the client's organisation as the control weaknesses inherent in a system are likely to be disclosed by such charts. At any rate, the features of internal control will depend among other factors on:

1. The nature and size of the business conducted.
2. The number of administrative staff involved.
3. The materiality of transactions concerned.
4. The importance placed upon the internal control system by the management.
5. The management style of the entity, particularly the trust placed on the integrity of the key person and the latter's ability to supervise and control his/her subordinate staff.

3.2 Features of Internal Control System

However, the following are the features of internal control system.

1. A Whole System

Internal control can be seen as single procedures or as a whole system. The whole system is more than the sum of the parts.

2. Established by the Management

Internal control systems are established by the management directly or by means of external consultants, internal audit, or accounting personnel.
3. **Ensure Adherence to Management Policies**

An effective internal control system will enable an organisation to implement its plans and policies as laid down by the management.

4. **Safeguarding the Assets of An Organisation**

An effective internal control system guards and protects the resources of an organisation. It ensures that the financial resources of an organisation are not misappropriated or embezzled, and also ensures that the physical assets of an organisation are not misused.

5. **Accuracy of the Records**

An internal control system enables the records of the organisation to be complete and accurate. It also ensures that the books of account are not tampered with by unauthorised persons.

6. **Financial and Other Controls**

Internal control makes use of financial control such as the use of control accounts. It also makes use of other control measures such as physical access restriction to computer terminals.

3.3 **Internal Control and Statutory Audit**

With the complexity in business environment, internal control forms the basis of modern auditing as it is neither desirable nor reasonable for an auditor to carry out hundred percent checks of all the transactions entered into by a client during the course of the financial period. The internal control system in an organisation (with its strengths and weaknesses) provides the auditor with reasonable number of evidence which enables him express an opinion on the client’s financial statement after its proper evaluation.

Otherwise, the work of an auditor will be so boring, uninteresting and quite discouraging with the attendant heavy burden on the client. While it is the responsibility of management to set up and maintain the internal control system, it should be clearly stated that the annual audit exercise is not a substitute for effective management control.
3.4 Reports to Management on Internal Control Systems

It is the management's responsibility to prepare financial statements and institute control systems in operation to forestall the occurrence of frauds and errors. It is the auditor's responsibility to assess the effectiveness of a client's control system so as to determine the extent of reliance to place on the controls. During the course of an audit, the auditor may come across weaknesses in the client's system which may undermine the completeness, accuracy and validity of the client's transactions.

In this regard, the auditor has a professional duty to provide constructive criticisms of the client's system in a formal report to the client's management known as the management letter (ML) or letter of control weaknesses (LCW) or domestic report (DR).

This letter should not only highlight the weaknesses that come to the auditors' attention during the audit, it should also highlight the likely consequences of such weaknesses and the auditor's recommendations to improve the system in the future.

The fact that the auditor reports to management on control systems does not diminish the management's responsibility from instituting effective control systems and neither does it prevent the auditors from considering the effects of such weaknesses on the auditor's tests and procedures.

It is a good practice to follow-up all management letter points on subsequent audit visits so as to ensure that the auditor's recommendations have been implemented. If the auditors establish that the weaknesses are still in existence, it is customary to write a fresh management letter, drawing attention to previous weaknesses earlier highlighted. This in effect implies that as long as a weakness remains in the client's system, references should always be made to it in new reports written to the client's management.

3.5 Internal Check

Internal check is part of the internal control system. It has been defined to mean those routine day-to-day controls over transactions which are designed to minimise the risk of errors and irregularities. Internal check includes:

1. Controls designed to ensure that the duties of authorisation, execution, recording and custody are not done by one employee.
2. Supervisory controls exercised by middle and lower level management over the work of subordinates.
3. Arithmetical and accounting controls designed to ensure the accuracy, completeness and correctness of records and especially those controls to ensure that the work of one person is independently proven by that of another in the normal course of his work.

4.0 CONCLUSION

The features of any internal control system should include a whole system, established by the management, ensure adherence to management policies, safeguarding the assets of an organisation, accuracy of the records, and financial and other controls. These features are as a result of determining factors such as the nature and size of the business conducted the numbers of administrative staff involved, the materiality of transactions concerned, the importance placed upon the internal control system by the management and the management style of the entity.

5.0 SUMMARY

The nature, size and scope of an internal control system is normally determined, amongst other factors, by the nature and size of the organisation’s business, number of staff available, materiality of transaction concerned and management style.

Some of the salient attributes of an internal control system are: it is a whole system; it is established by management and ensures adherence to management policies.

With the complexity in business environment, internal control forms the basis of modern auditing, as it is neither desirable nor reasonable for an auditor to carry out hundred percent checks of all the transactions entered into by a client during the course of the financial period.

Effective reporting is one vital component of a sound internal control system. Different internal control reports are written for different reasons. One of such report is “management letter”. A management letter is a formal letter written by the auditor to the management of its client, highlighting the inherent drawbacks in the internal control system, the likely consequences if the risks should materialise, as well as recommendations to improve the system.
One vital element of internal control system is internal check. It is those routine day-to-day controls over transactions which are designed to minimise the risk of errors and irregularities. Internal check ensures the system works well and helps to achieve the intended objectives for which the system is designed.

6.0 TUTOR-MARKED ASSIGNMENT

i. What are the factors determining internal control system
ii. Mention and explain the features of internal control system
iii. What is the relationship between internal control and statutory audit?
iv. What are the responsibilities of management and auditors on internal control reports?
v. What is internal check? And what does it comprise of?

7.0 REFERENCES/FURTHER READING


UNIT 1 INTERNAL AUDIT

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Internal Audit Defined
   3.2 Functions of Internal Audit
   3.3 Essential Elements of Internal Audit
   3.4 Organisation of Internal Audit Department
   3.5 Scope and Objective of the Internal Audit Function
   3.6 Internal Audit Report
   3.7 Audit of Internal Control System (System Based Audit)
   3.8 Comparison of Internal Control Questionnaire with the Internal Control Evaluation Questionnaire
   3.9 Internal Audit Programmes and Working Papers
   3.10 Control Objectives and Detailed Controls in Various Areas of Business
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

No internal control system can work without providing it with some supporting structures. These structures tend to drive the whole system to ensure that they operate effectively and optimally. One of these structures is “internal audit”.
Internal audit is an independent appraisal function within an organisation for the review of activities, in order to review the accounting systems and related internal controls.

In this unit, we shall examine the definition of internal audit, functions, elements, internal audit reports and programmes, e. t. c.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

• define internal audit
• classify the functions of internal audit
• discuss the elements of internal audit
• explain the term internal audit report
• discuss the audit of internal control system
• compare the internal control questionnaire with the internal control evaluation questionnaire
• discuss on internal audit programmes and working papers.

3.0 MAIN CONTENT

3.1 Internal Audit Defined

Internal audit is an element of the internal check system set up by the management of an enterprise to carry out a review of the accounting and internal check system. The internal audit assigned staffs that make up the internal audit department. It is an independent appraisal function within an organisation for the review of various activities as a service to all levels of management. It is a form of control to measure, evaluate and report upon the effectiveness of other controls, financial and otherwise as a contribution to the effective use of the resources within the organisation.

3.2 Functions of Internal Audit

What functions do internal audit perform?

1. Review of accounting systems and related internal controls
2. Examination of financial and operational information for management
3. Review of the economy, efficiency and effectiveness of operations
4. Assistance in the implementation of new accounting system
5. Review of the implementation of corporate policies, plans and procedures
6. Special investigation.

Let us throw some light on these functions:

1. **Review of Accounting Systems and Related Internal Controls**

   Internal audit is often assigned specific responsibility for the following tasks:
   
   - Reviewing the design of the systems
   - Monitoring the operations of the systems by risk assessment and detailed testing
   - Recommending cost effective improvements
   
   These reviews will normally cover both financial and non-financial controls.

2. **Examination of Financial and Operating Information for Management**

   This may include review of the means used to identify, measure, classify and report such information and specific enquiry into individual items including detailed testing of transactions, balances and procedures.

3. **Review of Economy, Efficiency and Effectiveness of Operations**

   Internal audit ensures that the resources of the organisation are prudently managed in a manner that will save time and still achieve set targets and goals.

4. **Assistance in the Implementation of New Accounting System**

   In instituting new accounting systems, internal audit personnel must be involved in all the phases to provide technical assistance. When they are involved in putting in place this system, it becomes relatively easier to review the system for effectiveness and value-adding.

This includes review of the effectiveness of planning, the relevance of standards and policies, the organisation’s corporate governance procedures and the operation of the specific procedures such as communication of information.

6. Special Investigations

This may include cases of suspected fraud.

3.3 Essential Elements of Internal Audit

1. Independence

Internal auditing is carried out by independent personnel. Internal auditors are employees of the firm and their independence is not always easy to achieve. However, it can be assisted by:

- Having the freedom to arrange its own priorities and activities
- Having unrestricted access to record assets and personnel
- Freedom to report to higher management and where it exists to an audit committee
- Internal audit personnel who have no conflicts of interest or any restrictions placed upon their work by management
- Internal audit personnel who have no non-audit work.

2. Training

All internal audit staff should be trained

3. Staffing

The internal audit department should be adequately staffed in terms of numbers, grade and experience.

4. Relationships

The internal auditors should foster constructive working relationship and mutual understanding with management, external auditors, and any review agencies.

5. Due Care

The internal auditor should behave as much as an external auditor in terms of skill, care and judgment. He should be up to date technically and have personal standards of knowledge, honesty, probity and integrity as much as an external auditor.
6. Systems Controls

The internal auditor must verify the operations of the system in the same way as an external auditor i.e. by investigation, recording, identification of controls and compliance testing of the controls.

3.4 Organisation of Internal Audit Department

Internal audit being a management tool will be whatever the management wants to make it in order to achieve their objective. Ideally, internal audit department should be headed by a chief internal auditor or better still a 'director of internal audit’ who should be on the same level with all other departmental heads if he is to command respect. The chief internal auditor or the director of internal audit as the case may be, should report directly to the MD/CEO/management board but not to any of his peers as the main job of the internal auditor is to appraise and report on the activities of other departmental heads.

Therefore, for effectiveness and to enjoy a reasonable degree of independence, the head of internal audit should report to the apex authority of the organisation. The other members of the team which may include the principal or senior internal auditor, internal auditor I or senior executive officer and internal auditor II or higher executive officer, etc. have been provided by the accountancy profession because of the training of accountants which includes a lot of analytical techniques. Nowadays, all these have changed. The emphasis is placed on the supportive role to management rather than checking the accuracy of accounting records and business transactions.

Though for the purpose of proper coordination, it is advisable that internal audit department should be staffed with those knowledgeable in accounting and book-keeping. Meanwhile, just as other departments or functional areas within an organisation, the internal audit department should have 'its own crop of managerial, supervisory and clerical staff with properly defined reporting line. Audit department should not be seen as an extension of bursary or treasury department but a separate unit.

3.5 Scope and Objective of the Internal Audit Function

The scope and objective of the internal audit function is dependent on its terms of reference as stated by management, the size and nature of the enterprise, the number and experience of the internal audit staff and skill
and competence possessed by the internal auditors. Internal auditors are found however to operate in the following broad areas:

1. Review of accounting and internal check system on behalf of the management.
2. Review of the economy of production and many accounting controls.
3. Review of implementation status of management policies, plans and budgets.
4. Review of management accounts and report on behalf of management.
5. Special investigation.

3.6 Internal Audit Report

Unlike the statutory auditor’s report, the internal auditors report need not follow the reporting standard or guidelines as there is no regulatory body that regulates the conduct of internal audit. However, it must follow the normal pattern of report writing which comprise of heading, introduction, paragraphs, the main body of the report dealing with observations and findings, recommendations for corrective measures and conclusions.

This report is addressed to the management or whoever is responsible.

Internal audit report is the medium by which the internal auditor’s views are conveyed to the board of directors and the management. It covers the evaluation of the internal control system, accounting systems, periodical reports on the activity of each functional area (dealing with their efficiency and compliance with the management policies and objectives) and reports on the results on special investigations and enquiries.

For internal audit report to achieve its goals of assisting management efficiency, its contents and recommendations must be given adequate attention by the management and followed by the necessary corrective actions. Meanwhile, management must also provide necessary equipment to the internal audit department and they should make sure necessary corrective action is taken by the management based on the recommendations in the internal audit report. It may be necessary to write a follow-up report which should be copied to a higher level of authority than the one reported on for compliance directive. Hence, it is recommended that the chief internal auditor or director of internal audit should not occupy any level lower than that of the functional managers.
and should report directly either to the chief executive officer or to the audit committee in the case of a public company.

### 3.7 Audit of Internal Control System (System Based Audit)

When an auditor decides to place reliance on a client on the internal control system, he will have to (i) ascertain it, (ii) record it, and (iii) evaluate it. This audit approach involves the use of compliance tests.

Compliance tests provide audit evidence that internal control procedures are being applied as prescribed.

#### 3.7.1 Ascertainment

For a new client, ascertain the internal control in operation through enquiring from management, inspection of records and observation. For an old client, update the internal control system to reflect current situation.

#### 3.7.2 Recording

For practical purpose, record the internal control system through narrative notes, internal control questionnaire and flow charts.

(i) **Narrative Notes**

These are narrative notes describing the internal control system of an organisation. This method has been widely criticised in the sense that when badly written, identification of the control with the system may not be possible from the note. However the criticism may be overcome by adopting a disciplined approach in writing the system notes.

(ii) **Internal Control Questionnaire (ICQ)**

This is an elaborate set of questions covering every facet of the internal control system of an organisation. It entails framing the questions in such a way as to call for descriptive answers. The preparation of an ICQ involves the following steps:

a. Divide the system into appropriate section(s).
b. Questions should be framed in a way to require detailed description of the system.
c. Ask questions that identify relevant controls.
ICQs are usually completed by attendance and care should be taken when completing the questionnaire so that the answers given relate to what is actually happening and not what the client's staff feel the auditor wants to hear. Examples of internal control questionnaires on:

(a) **Salaries**

- What is the procedure for engaging new employees?
- Who are responsible for salary preparation and payment?
- What are the procedures for ensuring that employee who received salary actually worked for such remuneration received?
- How is the incidence of ghost workers avoided?
- What happens to unclaimed salaries?
- What is the identification procedure during salary pay-out?

(b) **Purchases**

- When is an order for goods raised?
- Who initiates an order for goods?
- What is the procedure for ensuring authorisation of order?
- How is order price being determined?
- What is the procedure for ensuring compliance of goods supplied with order?
- How does the company ensure that only goods ordered are delivered and paid for?

This questionnaire intends to establish how good a client's control system is. Where there are weaknesses in the system, the auditor is advised to review:

(a) The errors and frauds which are likely to exist.
(b) The materiality of such errors and frauds in the client's financial statements.
(c) The substantive audit tests to perform to detect such errors and frauds.

In designing an ICQ, the auditor should take into account the following:

(a) A blank ICQ should be designed for each new client only if the size and the nature of operation is complex. For a small business, the controls can be assessed by putting across questions to the
client and carefully noting the replies. In addition, it is advisable to perform a physical observation of procedures.

(b) The useful life of an ICQ should not exceed 5 years,’ meaning in effect that the ICQ should be updated when necessary. It is advisable to compile an ICQ from the scratch when there is a sudden change in the client's systems, for example, where a client changes from a manual system to a computerised system.

(c) The ICQ should be compiled by an experienced member of the audit team at a pre-arranged meeting, putting across relevant questions to the client's staff about the operations.

(d) The questions should be designed in such a way as to require simple yes or no answers. A "yes" answer indicates a potential strength and a "no" answer indicates a potential weakness in the system.

(e) The answers to the questions in an ICQ should be corroborated by the auditor on a test observation basis, so as to ensure that controls do exist in practice.

Advantages of Internal Control Questionnaire

1. It ensures that all important questions are asked.
2. All the features of the system are highlighted and tested.
3. It is specifically designed for identifying areas of weaknesses.
4. It assists the auditor in understanding the system.
5. It provides a check list of what to do for the auditor.
6. It assists the auditor to draft a management letter.

Disadvantages of Internal Control Questionnaire

1. It does not by itself evaluate significant areas of weakness.
2. It can inhibit the exercise of initiative of the user.
3. The expenses and time involved in the preparation may not be justified.
4. Internal control questionnaire may encourage mechanical replies.

(iii) Flow Charts

This is a diagrammatical representation of internal control system showing:

- Movement of documents
- Sequence of operations
- Check procedures built into the system
- Segregation of duties.
Techniques of Flow Charting

The following principles should be followed when preparing a flow chart for effective communication

a. Where standard flow chart symbols are not used, a key should always be provided.
b. Flow lines should move vertically from top to bottom.
c. Operations should be shown in strict chronology order and sequentially numbered.
d. Narrative description should be minimised and shown on the extreme left hand column.
e. The title and name of the person responsible for each operation should be shown in a responsibilities column.
f. It should be simple, clear and unambiguous for easy understanding.

3.7.3 Evaluation

Evaluate the control to determine whether they are satisfactory in principle by using internal control evaluation questionnaire (ICEQ). The result of evaluation process determines the volume and nature of audit work to be done in expressing opinion on the financial statements.

Although, ICEQ is similar to internal control questionnaire, the difference lies in the fact while ICQ requires detailed set of answers, ICEQ deals with yes or no answer only. The questions are normally in two fold, the "key question" which goes straight to the heart of the matter and the "subsidiary question" which influence the answered question. Below are examples of internal control evaluation questionnaire (ICEQ) on:

(a) Salaries

- Can employees be paid for work not done?
- Are time clocks supervised by a responsible official?
- Are time records and piece work sheets checked before processed for accuracy and authorisation?
- Are time records and piece work sheets controlled by persons independent of the payroll department?
- Are proper controls exercised over adjustments, lateness, sickness and absenteeism?
• Are adequate safeguards operated over cash payment and unclaimed salaries?

(b) Purchases

• Can goods or services be ordered without being authorised?
• Are purchase orders/requisitions prepared and approved by responsible officials?
• Are there any limits of authority operating over ordering of goods and services?
• Are purchase orders pre-numbered and, numbers accounted for?
• Are purchases orders valued and compared with existing budgets and other management policies?
• Is segregation of duties being exercised over purchase orders?

In modern auditing, practicing firms now use evaluation questionnaires to evaluate the materiality of client's control systems rather than focusing on the establishment of controls in practice.

In designing the ICEQ, the objective is to ensure that there are effective key controls to forestall the occurrence of frauds and errors in operation.

As stated earlier, the questions in an ICEQ require yes or no answers, where a "yes" answer indicates strength and a "no" answer indicates weakness in the system.

Where the auditors become aware of weaknesses in the system as a result of the ICEQ assessment, they should establish the existence of compensating controls to counter balance the situation.

3.8 Comparison of Internal Control Questionnaire with the Internal Control Evaluation Questionnaire

3.8.1 Similarity

The objectives of the two (i.e. both instruments) are the same, that is, to evaluate the system of controls

3.8.2 Differences

1. Internal control questionnaire incorporates a number of detailed questions without attempting to distinguish their materiality. The internal control evaluation questionnaire on the other hand isolates control objectives within the area under review.
2. The answer "no" in an internal control questionnaire indicates a weakness while "no" indicates a strength/compliance in an internal control evaluation questionnaire and vice versa.

3.8.3 Advantages of Internal Control Evaluation Questionnaire (ICEQ) over Internal Control Questionnaire (ICQ)

1. Materials and non-material errors are highlighted.
2. It highlights only the key controls.
3. It enhances the drafting of a management letter.
4. It points the attention of audit staff to matters fundamental to controls in the areas under review.
5. A completed internal control evaluation questionnaire will assist the auditor in determining the nature and extent of his tests and procedures.

In the process of evaluation, auditors carry out work-through tests to ascertain the correctness of the system. A work-through test is the tracing of transactions from inception of the records to the conclusion.

Auditors also conduct compliance tests on the controls before finally reporting on the weakness in the internal control system to the management by writing a management letter or what is otherwise known as a domestic report.

3.9 Internal Audit Programmes and Working Papers

For effective internal auditing, an internal auditor's approach should adopt a reasonable measure of standardisation for effective monitoring and control with a little flexibility which allows for the use of initiatives when circumstance warrants. To this effect an internal audit programme, can either be a standard one or a special audit programme. Standard audit programmes are those developed to meet the need of every circumstance while special audit programmes are developed for a specific situation. Experience has shown that where the system of internal check is adequate, less time is normally devoted to routine checking involving the use of standard audit programme but more time is spent on constructive work which aids management in its tasks of managing the business profitably and this calls for an informal approach with the use of initiatives on the part of the internal auditor.

The use of standard audit programmes however, has the following merits:
1. It provides the internal auditors with a framework for their activities along logical lines.
2. It indicates the minimum level of test checking which is regarded as necessary on the assumption that the system of internal check is adequate.
3. It provides immense help to the external auditor in designing their audit programmes so as to remove unnecessary duplication of work.
4. It encourages the achievement of a balanced audit at each accounting point and also a balanced audit throughout the whole of the organisation.
5. It allows for the movement of staff from one assignment to the other without loss of continuity.

The use of standard audit programmes also has demerits. The demerits are as follows:

1. Standard audit programmes tend to destroy initiative by allowing the internal auditor to carry out the content of standard audit programme and no more.
2. When completely adhered to, it turns the work of internal auditor to a mechanically routine work.
3. It sometimes causes a sense of frustration in the mind of internal auditors when anxious to explore certain accounting features which standard audit programme may not allow.
4. It makes the extent of audit to become known or predictable to accounting personnel. Hence, the moral check imposed by audit is therefore lost.

Meanwhile, it should be borne in mind that an audit programme should not be a substitute to personal judgment and it should normally be regarded as a guide.

As in statutory audits, the internal audit working papers are the evidences of work done and steps taken by the internal auditor as a basis for his report. The working paper shows the details of work done by the auditor to enable him form an opinion on the accounts or set of account he is required to report on. For this reason, therefore, great care should be taken in the preparation, indexing and preservation of his working paper. A good working paper should have the following features:

1. Check List: these are of those work (things) done on the audit, that is, things needed for the completion of audit work.
2. Clear and neat exposition of the make-up of figures, accounts, reports and summaries.
3. Complete but concise narratives of the work done in preparing the schedule.
4. Cross reference to other current schedules and to earlier papers or reports and ease of retrieval by standard sequences and good indexing.
5. Details of personal and third party verifications.

Audit working papers could be permanent or current working papers.

The permanent working paper contains information of continuous importance to the organisation. The contents of permanent working papers are:

1. Copies of certificate of incorporation and of the company auditor’s appointment and engagement letters.
2. Memorandum and articles of association of the company.
3. Organisation’s major accounting policies.
4. Organisational structure or management set up.
5. List of directors and their interest.
6. List of shareholders with more than 10% holdings.
7. Nature of the client business, registered office and branch network and their addresses.
8. Copies of the financial statements to date.
9. Names and addresses of company’s professional advisers.
10. First audit planning memorandum written for the company.
11. Statement of important ratios of the company.
12. Description of accounting and internal control system.
13. List of authorised signatories for the company and the signatures.
14. Specimen copy of all transactions document e.g. form voucher, goods delivery note, goods received note, payment voucher and petty cash voucher etc.

The current working paper contains current information and its contents are:

1. Schedule of major items in the financial statement.
2. The audit programme.
3. Letter of internal control weakness.
4. Extract of board meeting decisions/extract of the minutes of board meetings held during the year.
5. Current copy of audit planning memorandum
6. All correspondence with the company on current audit
7. Letter of representation
8. Copy of letter of comfort from a lawyer on impending litigation against the company. (Otherwise called letter of attorney)
9. Reply to all circularisation
10. List of all audit queries and their disposition
11. We also need the current audited financial statement document.

3.10 Control Objectives and Detailed Controls in Various Areas of Business

I. Cash Receipt by Post

Control Objective

• All receipts through the post must be properly accounted for.

Detailed Controls

• Procedures should be established to ensure that cheques and cash sent through the post are not intercepted e.g. post office box key should be made available to authorised officials only.
• A responsible person should be authorised to open all the post office boxes independent of the cashier.
• Post must be opened in the presence of at least 2 persons.
• All cheques or any other reportable instruments received through the post should be restrictively crossed “account payee only”.
• A memorandum cash book or post list should be made listing all cash and cheque received through post. The list should include information such as the payer, cheque number, date received and the amount.
• The memorandum cash book or post list should be signed by the persons present as an acknowledgement of the correctness of the details included.
• There should be a reconciliation of the pay in slip with the memorandum cash book. The reconciliation should be carried out by an independent person.

II. Cash Collections (Credit Sales)

Control Objectives

• All cash due to the company are collected
• All cash collections are properly accounted for
• All cash is collected by authorised persons only
• Cash collections are correctly and completely recorded

**Detailed Controls**

• Cash collections should be restricted to authorised persons only
• All cash collected must be issued with official receipt and customers should be enlightened of the need to collect receipts evidencing payment
• Receipts should be properly controlled and must be sequentially pre-numbered; receipt booklet should be issued to properly authorised personnel
• Periodic review by specified personnel to ensure that all transactions in the receipts booklet are properly accounted for
• Cash collected should be properly safeguarded. For example by the provision of a safe
• Where cash is collected by field agents including insurance agents, salesmen etc, and adequate provision must be made to ensure that all collections are properly accounted for
• Sales agents should be issued with delivery notes at selling prices to enhance accountability
• A daily cash summary of all collection should be prepared and an independent reconciliation of the daily cash summary with details of the receipts and bank pay in slip should be carried out.

**III. Cash Payment**

**Control Objectives:** to ensure that:

• Payments are made for only goods and services rendered
• Payments are made to the right supplier in the correct amount
• To ensure that payments are properly authorised.
• Cheques are signed by authorised persons
• Payments are properly and correctly recorded.

**Detailed Controls**

• A responsible person should authorise invoices for payment. Such authorisation should be made only after ensuring that the transaction is in order, goods or services have been received and that the invoice is arithmetically correct
• An authorised person should be responsible for signing all cheques
• Invoice approved for payment must be supported by all documents including purchase orders, goods delivery note, goods received note e.t.c. and the document must be checked before cheques are signed
• All paid invoices must be properly stamped ‘paid’ to avoid them being presented for payment more than once
• Adequate custody must be established over cheque books. Controls in the area include ensuring that cheque booklet is issued to only authorised persons
• A daily summary of cheque payments should be prepared and independently reviewed with the details of bank statements and cheque stubs.

IV. Banking of Cash Collections

Control Objective

• To ensure that all cash collected are banked promptly and are intact

Detailed Controls

• Bank pay-in-slip should be prepared by a person who has no access to cash
• All cash and cheques collected should be banked intact and promptly preferably every other day
• Consideration must be given to the provision of adequate security for cash in transit e.g. the use of security organisations
• There should be an independent reconciliation of bank pay-in-slips with record of cash collection.

V. Bank Balances

Control Objectives: to ensure:

• The correctness of balances shown by the bank statements as well as the cash book
• That banking transactions are proper and bona fide.

Detailed Controls

• Bank reconciliation statements should be made by a person independent of those with previous contact with the cash or those in charge of recording cash transactions
Adequate arrangements should be established to ensure that bank statements are not intercepted by unauthorised person and that the bank statements are sent directly to the independent person in charge of preparing the reconciliation.

All rejected cheques must be properly investigated to determine the reasons for their rejection.

All reconciling items must be properly investigated in order to ensure that they are in order. Such items include un-presented cheques, direct credit and bank charges.

A confirmation should be obtained from the bank periodically.

VI. Wages and Salaries

Control Objectives: to ensure that:

- Salaries and wages are paid in the correct amount
- Salaries and wages are paid to bonafide staff in respect of goods produced and services rendered
- All deductions from salaries and wages are authorised and promptly paid over to the right authorities
- Salaries and wages are properly and correctly recorded
- The wages payout procedures are adequate.

Detailed Controls

- A record of all personnel including name, position, effective date of employment, gross pay, authorised deduction and other relevant particulars should be maintained by the personnel department
- Employees’ monthly pay should be reconciled with the production records and time records where applicable
- Salaries and wages should be prepared by an independent person in the accounting department
- The wages sheet should be properly reviewed for correctness by an officer before authorisation
- Monthly salaries and wages should be compared with those for prior periods and any significant variation must be properly investigated and accounted for
- There should be a proper analysis of wages and salaries into the different monetary denomination for bank collection purpose
- Adequate regard must be given to security measures to safeguard cash collections from the bank
- Wages should be bagged by a person other than the person in charge of preparing the payroll
• The time and place of payment of wages and salaries must be made known to all staff in advance e.g. in a large factory
• All payments should be made in the presence of supervisors who should identify staff or alternatively identity cards should be presented on collection of payment by staffs
• All collections on behalf of any staff must be supported by proper authorisation
• Uncollected wages must be properly safeguarded and recorded. They must also be properly investigated and returned to the bank after the expiration of a specified period of time
• All deductions in respect of pension fund and income taxes must be paid over promptly to the appropriate authorities
• A record of salaries and wages should be prepared by a person independent of those with previous connections to the wages procedures. Such records must be reviewed for completeness and accuracy.

VII. Buildings

Control Objective

To determine whether the figure is fairly stated

(a) Steps in Control

• Obtain detailed schedule of building stating balance brought forward, additions, disposals and balance carried forward.
• Check cost to ensure arithmetical accuracy

Agree opening balance to prior year audited accounts and working papers.

• Vouch addition and ensure that they were authorised and bonafide
• Ensure that additions represent capital expenditure and have been correctly recorded
• Review disposal and ensure that they are bonafide and have been correctly recorded in the books
• Vouch disposal proceeds to the cash book or accounts receivable.

(b) Existence

Inspect building to ensure existence. Where the auditor cannot inspect the building physically, he can rely on the following: rates, electricity bills, rental income, repairs on building and
ground rent. Where the value of a particular building is material, it is very important for the auditor to inspect it either by contracting the inspection to professionals or asking his regional office to do the job on his behalf.

- Obtain and review documents evidencing ownership (certificate of occupancy) and ensure that the building belong to the company.
- Obtain and review lease agreements to ensure that the company has lease hold interest over the buildings.
- Ensure that buildings are free of outside interest e.g. by being mortgaged.
- Confirm that buildings held by third parties on behalf of the company are held free of interest.

(c) **Valuation of buildings**

i. Constructed buildings: direct material, direct labour and fixed overhead

ii. Purchased buildings: purchase cost.

iii. Lease hold buildings: capital sum paid for the lease and should be amortised over the life of the lease

**Note:** ensure compliance with SAS 3

**Verification of Building Revaluation**

- Ensure that revaluation is carried out by professionals that are independent, competent, experienced and have integrity
- Ensure that assumptions made are reasonable
- Ensure that all surpluses on revaluation have been posted to revaluation accounts
- Obtain and review the assumptions in carrying out revaluation.

The following factors should also be noted:

- That revaluation surplus are posted to revaluation account and shown as part of shareholders equity
- That provision has been made for deferred tax where necessary i.e. where you think building is going to be sold in the nearest future
- That building are properly presented and disclosed in the financial statements
- Obtain a representation letter from the management.
VIII. Plant and Machinery

Control Objective

To determine whether the figures are fairly stated

Detailed Controls

- Obtain a schedule of plant and machinery stating among others balance brought forward, addition and disposal in the year
- Check cost to ensure arithmetical accuracy
- Agree opening balance to prior year audited accounts and working papers, plant and machinery register and the general ledger
- Vouch additions during the year and ensure that they are bonafide
- Ensure that additions include only capital expenditure items
- Vouch disposals and ensure that they have been properly treated in the book and that they are bonafide
- On a test basis verify the existence of plant and machinery through physical inspection
- Review documentary evidence of ownership, such as invoice, licenses etc and ensure that the assets belong to the company
- Review for plant and machinery that have been pledged to third parties in respect of obligations to them
- Ensure that adequate provision for depreciation in respect of plant and machinery account for the year on a basis consistent with prior year and which are acceptable
- Obtain a letter of representation from management
- Ensure that all material fact and information regarding plant and machinery are properly disclosed in the financial statement.

IX. Debentures

Detailed Controls: In respect of debentures from previous years:

- Obtain details of debenture balances outstanding as at the end of the year
- The details should also state the balance brought forward, additions and repayment during the period
- Ensure that debenture interest is paid as at when due to debenture holders
- Ensure that the portion of debenture repayable during the period has been paid
Where there is a provision to set aside an amount annually to a debenture redemption reserve funds, ensure that such an amount is properly set aside

- Obtain a letter of representation from management
- Ensure that debenture balances are properly stated and other information necessary for a proper understanding of the financial statement are disclosed.

**Detailed Controls:** In respect of debentures taking during the year as follows:

- Review the minutes of directors meeting and ensure that they are authorised
- Review the company’s memorandum and article of association and ensure that the debenture is not ultra-vires the company and the power of directors
- Where the loan is not ultra-vires the company, but directors have no power to enter into such loan agreements, ensure that a resolution has been passed by the share holders in a general meeting authorising the loans
- Obtain the debenture deed and review the terms regarding interest, security and the repayment of capital
- Ensure that the debenture agreement has been properly registered as a security in accordance with CAMA 1990
- Vouch receipts to cashbook.

X. **Current Liabilities**

**Detailed Controls**

- Obtain details of creditors as at the end of the year showing opening balances and closing balances
- Check the accuracy of the schedule obtained
- On a test basis, select some purchase orders and vouch them to goods receipt note, received suppliers invoice and credit entries in the suppliers account
- Select some suppliers balance and trace credit purchase during the year back to relevant purchase order
- The objectives of step 3 above is on one hand to ensure that all purchases are recorded and on the other hand to ensure that all entries in the suppliers account represent purchase transaction that actually took place during the year
- On a test basis, vouch payment to suppliers during the year to cash book
• Circularise creditors balance
• Obtain a letter of representation from management
• Ensure that creditors’ balances are properly stated in the financial statement.

XI. Bank Overdraft (Bank O/D)

Detailed Objectives

• Obtain details of overdraft outstanding as at the year end
• Review the minutes of directors meetings and ensure that additional overdraft taken during the year is properly authorised
• Review overdraft agreement and ensure that all the terms including interest and repayment of principal had been adhered to by the company
• Review and determine whether any asset has been offered as security for bank over draft and if this is so, whether the fact is disclosed in the financial statement
• Obtain confirmation from the banks regarding balances outstanding as at the end of the period
• Obtain a written representation from management as at the end of the period
• Ensure that bank over draft is properly stated and material fact properly disclosed in the financial statement.

XII. Taxation

Control Objective: to ensure that:

• The figure is fairly stated

Detailed Controls

• Verification of tax balances
• Obtain details of the taxation account in the general ledger
• Agree the opening balances to last year audited account and audit working papers
• Obtain the clients tax computation for the year and review it to ensure that it has been properly prepared. Where the client has not prepared a tax computation, the auditor should prepare one and ensure that the amount provided in the financial statement and charged for the year is fairly stated.
4.0 CONCLUSION

The internal audit is an independent appraisal function within an organisation for the review of activities. It includes independence, training, staffing, relationships, due care, and systems controls. Internal audit being a management tool will be whatever the management wants to make it in order to achieve their objectives. Ideally, internal audit department should be headed by a chief internal auditor or better still a 'director of internal audit’ who should be on the same level with all other departmental heads if he is to command respect. The scope and objective of the internal audit function is dependent on its terms of references as stated by management, the size and nature of the enterprise, the number and experience of the internal audit staff and skill and competence possessed by the internal auditors. Unlike the statutory auditor’s report, the internal auditors report need not follow the reporting standard or guidelines as there is no regulatory body that regulates the conduct of internal audit. However, it must follow the normal pattern of report writing which comprises heading, introduction, paragraphing, the main body of the report dealing with observations and findings, recommendations for corrective measures and conclusions.

5.0 SUMMARY

Internal audit is an independent appraisal function within an organisation set up for the review of other components of the system and as a service to all levels of management. It performs wide-ranging functions which include: review of accounting system and related internal controls, as well as review of the economy, efficiency and effectiveness of operations.

Internal audit has various elements, some of which are: independence, due care, training and staffing. Its scope and objectives are dependent on the terms of reference stated by management, the size and nature of the enterprise and the number, experience and competency of internal control staff.

The internal audit department should be headed by a chief internal auditor who should be on the same level as all other department heads.

This is necessary to enable him perform his functions dispassionately and also to guaranty his independence and objectivity. The department should equally be staffed with people that are knowledgeable in accounting, book keeping as well as auditing.
On regular basis, internal auditors carry out reviews of organisation’s internal control system and reports on its effectiveness. These reports, if its content is to be treated seriously, should be directed to the board of directors or audit committees of the board. The report is an evaluation of the internal control and accounting system and report on the evaluation.

In discharging his responsibilities, an internal auditor uses tools such as enquiries, narrative notes, flowchart, internal control questionnaire, as well as internal control evaluation questionnaire. His work is facilitated by the use of internal audit programmes. These programmes could either be standard or specific. Standard audit programmes are those developed to meet the need of every circumstance while special audit programmes are developed for a specific situation.

The work of an internal audit, just like his external counterpart, is evidenced in a working paper. A working paper shows the details of work done by the auditor to enable him form an opinion on the accounts or set of account he is required to report on. The two types of working paper are: permanent and current.

For each areas of operation such as cash receipt, bank balances, wages and salaries, and to design an effective internal audit programmes, an organisation is expected to first identify relevant control objectives before designing detailed control activities.

6.0 TUTOR-MARKED ASSIGNMENT

i. What is internal audit?
ii. Mention four functions of internal audit
iii. List and explain five elements of internal audit
iv. Explain three things an auditor will have to do when he decides to place reliance on a client’s internal control system
v. Differentiate between internal control questionnaire (ICQ) and internal control evaluation questionnaire (ICEQ)
vi. List and discuss three documents for recording internal control system
vii. Write short notes on the following:
     viii. Organisation of internal audit department
     ix. Scope of the internal audit functions
     x. Internal audit report
xi. What are the advantages of internal control evaluation questionnaire (ICEQ) above internal control questionnaire (ICQ)

xii. Define a working paper and discuss the types.

xiii Mention the control objectives and detailed controls of the following areas of business
a. cash receipt by post  
b. cash payment  
c. bank balances  
d. buildings  
e. debentures  
f. bank overdraft

7.0 REFERENCES/FURTHER READING


UNIT 2  RELATIONSHIP BETWEEN INTERNAL AUDITOR AND THE EXTERNAL (INDEPENDENT/STATUTORY) AUDITOR

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Similarities between Internal Auditor and External Auditor
   3.2 Differences between Internal Auditor and Statutory Auditor
   3.3 Assessing the Effectiveness of the Internal Audit Department
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

The interest of internal auditors is derived from their position as staff of the organisation, and accordingly would want the system to operate efficiently and effectively. The external auditor on the other hand is interested in the internal control system so far as its effectiveness can assist in reducing the level of audit test on the transactions and balances processed through it or included in the financial statements. The scope of the internal audit function is determined by management. Whereas the scope of the external (statutory) auditors work is determined under the statute in which he was appointed.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

• indicate the similarities between internal auditor and external auditor
• differentiate between internal auditor and independent/statutory auditor
• assess the effectiveness of the internal audit department
3.0 MAIN CONTENT

3.1 Similarities between Internal Auditor and External Auditor

1. Common interest in the accounting and internal check controls:

The internal and external auditors both have vested interest in the accounting and internal check control. The interest of the internal auditors is derived from their positions as staff of the organisation, and accordingly would want the system to operate efficiently and effectively. The external auditor on the other hand is interested in the internal control system so far as its effectiveness can assist in reducing the level of audit test on the transactions and balances processed through it or included in the financial statements.

2. Similarities of Techniques or Methods

Both auditors adopt similar techniques and methods in recording and evaluating the system as well as carrying out their audit tests in recording the system. Both auditors would use a combination of three techniques: narrative or system note, internal control questionnaire and flowcharts.

Audit tests are of two types depending on their objectives. These are compliance test on the internal control systems and substantive test on the transaction and balances included in the accounts and the financial statement.

3. Independence

Both auditors are after independence from those whose work, they are reviewing. In this regard, the internal auditors report to the highest level of management and procedures are normally established to ensure that their remuneration, promotion and employment are not determined by middle level management.

4. Both auditors have common interest in the continuous effective operation of such system.

5. Both auditors have common interest in the adequate flow of management information.
6. Both auditors have common interest in the safeguarding of asset.

7. Both auditors have common interest in ensuring compliance with statutory and regulatory requirements.

3.2 Differences between Internal Auditor and Statutory Auditor

i. Scope

The scope of the internal audit function is determined by management. Whereas the scope of the external (statutory) auditors work is determined under the statute in which he was appointed.

ii. Approach

The approach adopted by the external (statutory) auditor is dictated by his statutory objective of forming an opinion and reporting on the financial statement whether they present a true and fair view. The internal auditor approach however is designed to ensure the effectiveness and efficiency of operation of the organisation.

iii. Responsibility

The internal auditors are responsible to management to whom they report, whereas the statutory auditor is primarily responsible to the shareholders to whom he reports.

iv. Appointment and Qualification

The internal auditors are appointed by management, whereas the external auditor is appointed by the shareholders usually at the annual general meeting. In addition, internal auditors need not possess any professional qualification. The external auditor on the other hand must be professionally qualified with a certificate permitting him to practice in Nigeria or any other country. Notwithstanding these, the statutory (external) auditor may rely to a large extent on the internal auditor in determining the strength of the internal control and assessing the general reliability of the accounting records.
3.3 Assessing the Effectiveness of the Internal Audit Department

The external auditor should be concerned with the following in making his assessment and the effectiveness of the internal audit department.

a. The degree of independence accorded the internal audit department in performing his functions
b. The qualification and experience of the internal auditor and the staff working with him
c. The depth, direction and timing of the tests and the audit evidence from which conclusions were drawn by the internal auditor.
d. The extent the management implements the recommendations and suggestions of the internal auditor’s reports.

With all these critically looked into and logically concluded the external auditor may reduce the level of his checking and tests but such reliance does not exempt him from liability inherent in the reliance.

4.0 CONCLUSION

In this unit, you have learnt about the similarities and differences between internal auditors and external auditors. You have also learnt the factors to be considered in assessing the effectiveness of internal audit department.

5.0 SUMMARY

The internal and external auditors have some similarities, just as they have areas of differences. In the areas of similarities, they both have common interest in accounting and internal control checks, use largely similar techniques in discharging their responsibilities and are both expected to be independent. In terms of differences, while the scope of internal auditors work is determined by management that of the external auditors is determined by statutes.

To assess the effectiveness of internal audit department, consideration should be given to the degree of independence accorded the department, the qualification and experience of the internal auditor and the staff working with him, amongst a host of other factors.
6.0  TUTOR-MARKED ASSIGNMENT

i. What are the similarities and differences between internal auditors and external auditors?

ii. Mention factors used in assessing the effectiveness of internal audit department.

7.0  REFERENCES/FURTHER READING


UNIT 3 ASSESSMENT AND EVALUATION OF INTERNAL AUDIT FUNCTION

CONTENTS

1.0 Introduction
2.0 Objective
3.0 Main Content
   3.1 Factors to be considered in Evaluating Internal Audit Function
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

The degree of independence of the internal auditor, technical competence of the internal audit staff, relevance of the scope and objective of the internal audit function, exercise of due professional care by the internal auditor in the conduct of his work, and quality of internal auditor report and extent to which management act upon them are factors to be considered in evaluating the internal audit function.

2.0 OBJECTIVE

At the end of this unit, you should be able to:

• Discuss factors to be considered in evaluating the internal audit function.

3.0 MAIN CONTENT

3.1 Factors to be considered in Evaluating Internal Audit Function

The external auditor should evaluate the internal audit functions to determine the extent to which he can rely upon their work. Factors to be considered during this evaluation include:

(i) Degree of independence
(ii) Technical competence
(iii) Scope and objective of the internal auditors
(iv) Due professional care; and
(v) Internal audit report.
These evaluation factors are discussed below:

1. **Degree of Independence**

   Internal auditors should be independent of those whose work they are reviewing and reporting upon. In order to ensure this independence, internal auditors should report to the highest level of management and should not be put in a situation where their employment, promotion and remuneration are determined by middle-level management. They should not have any functional responsibility and should be free to communicate with the external auditor who should be in a position to obtain all internal auditors’ reports required for his audit.

2. **Technical Competence**

   Internal auditors should be sufficiently competent in order to be able to discharge their internal auditing responsibilities. Evidence of technical competence will include membership of a professional body or the possession of relevant experience.

3. **Scope and Objective of the Internal Auditors**

   The external auditor should consider the relevance of the work of the internal auditors to his overall audit objective of expressing opinion on the financial statement.

4. **Due-Professional Care**

   The external auditor should consider the extent of the audit work. The audit work must appear to be properly planned, recorded, controlled and reviewed. Evidence of the exercise of due professional care will include the existence of an internal audit planning memorandum, the existence of proper documents, audit working papers.

5. **Internal Audit Report**

   The external auditor should consider the quality of internal auditor report and the extent to which management responds to and acts upon these reports.
4.0 CONCLUSION

The effective evaluation of internal audit function is based on the independence of the auditor, due professional care, technical competence, scope of his assignment and the quality of his internal audit report.

5.0 SUMMARY

External and internal auditors are expected to work collaboratively and not at cross purposes. To achieve this, the external auditor needs to evaluate the degree of independence the internal auditors enjoy, its technical competence, scope and objective of the internal auditors work and the quality of reports prepared by the internal auditor.

6.0 TUTOR-MARKED ASSIGNMENT

What are the evidence of technical competence of an auditor and his evidence in the exercise of his due professional care?

7.0 REFERENCES/FURTHER READING


UNIT 4  TECHNIQUES OF RECORDING IN HOSPITALITY ADMINISTRATION

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Revenue Centers
   3.2 Internal Control for Food and Beverage Sales
   3.3 Accounting Personnel and Front Office Functions
   3.4 Some Guidelines for Cashiers
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

Business transactions in hospitality administration can be grouped into major revenue centers, minor revenue centers and recreational centers.

There must be issue supporting schedules or departmental income statements for each revenue center. Sales and matching principle must be adhered to. Guest checks should be pre-numbered, tinted and have duplicates. Moreover, it should be kept in locked storage, in numerical order. Guest ledger includes individual records for each of the hotel's registered guests or an accumulation of guest and master folios. The opening machine totals for paid and paid-out must be the same figures that appear on the previous shift's cash report as the closing machine totals for paid and paid-out.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- group business activities into different revenue centers
- recognise the internal control for food and also the beverage sales
- state the function of accounting personnel and that of the front office
- explain the guidelines for recording activities by cashier
3.0 MAIN CONTENT

3.1 I-Revenue Centers

1. Categories of Revenue Centers
   - Major revenue centers (i.e. rooms, food & beverage)
   - Minor revenue centers (telephone, gift shops, newsstand, valet, laundry, barbershop or beauty salon)
   - Recreation centers

2. Revenue Centers and Financial Reports
   - Issue supporting schedules or departmental income statements for each revenue center
   - Separate food & beverage revenue center into two: Food schedule and beverage schedule
   - Might use more than one account for food and also for beverage
   - If the sales volume and expense items are not significant, they might be pooled to a single financial reporting category called other operated departments
   - The functions associated with some minor revenue centers may be leased to a concessionaire, and hence appear on hotel's schedule of rental and other income.

3. Fundamental Revenue Concepts
   - Sales and the matching principle
   - Upon depository receipt, cash a/c shall be debited and unearned revenue, deposits or credit balances shall be credited.

(a) Revenue Accounts

i. **Room Sales**
   Room allowances (contra revenue account)

ii. **Food Sales**
   Food allowances (contra revenue account)

iii. **Beverage Sales**
   Beverage allowances (contra revenue account)

(b) Other income--food and beverage department
iv. **Telephone Sales**

Telephone allowances (contra revenue account)
Other accounts for income earned by the hotel (ex: interest income, dividend income, rental income, concessions income, commissions’ income, vending machines income (less the cost of merchandise sold), and foreign exchange income)

- Net revenue = gross revenue - allowances
- Gross profit = net revenue - cost of sales (merchandise items)
- Gross profit = net revenue (ex: for room revenue)

### 3.2 II-Internal Control for Food and Beverage Sales

1. **Guest Check (also called Server's Checks)** This initiates the food & beverage order taken from the guest, and represents the invoice given to the guest.

- Guest checks should be pre-numbered, tinted and have duplicates. Moreover, it shall be kept in locked storage, in numerical order
- Used checks, unused checks versus void checks!
- Post to dinner, the server must price and total the guest check (applicable for manual systems), unless the point-of-sale equipment can automatically perform the addition
- Later, the cashier receives payment or makes the guest sign his/her guest check and deposits everything to the cashier
- At the end of the shift, the cashier's cash drawer and supporting documents are accounted for (i.e. cash, credit card vouchers, food charges, and any miscellaneous paid-outs). Later, they are reconciled against cash register reading using a daily cashier's report
- Beverage sales in a lounge, a bar… presents a harder job for internal control
- Some basic internal control procedures for beverage sales are listed as follows:

(i) Require the bartender to ring each sale as it is made
(ii) Require the bartender to insert each paid check into a locked box
(iii) The cash register drawer shall never remain open even for a small period of time
(iv) Servers are not allowed to first pay the bartender in cash and collect later from customers
(v) Bartenders should not be allowed to take register readings or reconcile their own cash at the end of their shifts
2. Guest Charge Privileges

These very privileges are allocated to guests who have provided an imprint of a valid credit card or were given a direct billing privilege at registration. In this case, all guest charges are recorded as debits in their respective guest, or master folios.

3.3 III-Accounting Personnel and Front Office Functions

- Guest ledger includes individual records for each of the hotel's registered guests or an accumulation of guest and master folios
- Guest ledger accounting (i.e. front office accounting) includes the accumulation of guest charges, credits and payments along with outstanding balances
- Guest ledger versus city ledger
- The accounting department is responsible for:

  (i) Recording the results of front office activities
  (ii) Maintaining the city ledger
  (iii) Accounting for credit card receivable
  (iv) Paying vendors
  (v) Handling payroll
  (vi) Preparing financial statements (i.e. consolidated income statement and balance sheet)
  (vii) Budgeting

Other Accounting Functions

The internal auditor should be responsible for:

- Entering all room charges, separating room taxes from room revenues and insuring that all vouchers have been accounted for and properly posted to each guest folio
- Preparing the front office room status report and reconcile it with the housekeeper's report for any room discrepancy
- Verifying Food & Beverage charges made to guests and charged to their rooms with the daily Food and Beverage sales reports. This duty is conducted, also, for all other revenue centers
- Guest folio errors (whether overcharges or undercharges) shall be corrected by the internal auditor using either a correction or an allowance voucher and posted to a separate allowance journal
- Preparing a summary report of the up-to-date amounts owed to the hotel in both guest ledger and city ledger accounts
3.4 IV-Some Guidelines for Cashiers

- The opening machine totals for paid and paid-out must be the same figures that appear on the previous shift's cash report as the closing machine totals for paid and paid-out
- At the close of the shift, the cashier should subtotal paid and paid-out for the current shift, and record the closing figures in the machine's totals column
- If at any stage, cashier accidentally miss-keys any transaction, adjustments can be made to the machine

Net cash received = cash paid-in (closing) - cash paid-in (beginning)  
Net cash paid-out = cash paid-out (closing) - cash paid-out (beginning)  
Net cash sum of cashier's shift = net cash received - net cash paid-out

- The cashier should extract the net cash sum from the cash drawer, and secure the money in the general cashier's safe deposit box until deposited in the Bank
- At the end of any shift, the cash drawer should contain exactly the same amount as it did when the cashier opened his/her shift
- If any cash overage or shortage occur, the cashier must recheck the cash report and search all the transaction records for possible miss-keyed entries

4.0 CONCLUSION

Hospitality business administrators should ensure that guidelines are given to cashiers after grouping their activities into different revenue centers. Accounting personnel must also perform their functions in ensuring the implementation of internal controls for food and beverage sales.

5.0 SUMMARY

A typical hospitality business has three categories of centres from which revenue accrues. These are major revenue centres (comprising rooms and food and beverage) minor revenue centres (comprising laundry, gift shops et cetera) and recreation revenue centres. Revenues are underpinned by fundamental revenue concepts which include sales and matching principle. Room sales, food sales, beverage sales and telephone sales are key revenue accounts prepared in a hospitality business.

For each of these revenue centres and in respect of the different accounts prepared, suitable internal control system are designed to ensure not
only the accuracy of these revenues, but also to ensure they are not prone to fraud or error. Examples of such controls for food and beverage sales are guest check and guest charge privileges.

6.0 TUTOR-MARKED ASSIGNMENT

Write the techniques of recording and functions in hospitality administration under the following headings:

(a) Guidelines for cashiers
(b) Accounting personnel and front office
(c) Internal control for food and beverage sales
(d) Revenue centers.

7.0 REFERENCES/FURTHER READING


UNIT 5  PROBLEMS OF INTERNAL CONTROL SYSTEM

CONTENTS

1.0  Introduction
2.0  Objective
3.0  Main Content
  3.1  Limitations of Internal Control System
4.0  Conclusion
5.0  Summary
6.0  Tutor-Marked Assignment
7.0  References/Further Reading

1.0  INTRODUCTION

No internal system however elaborate it maybe can by itself guarantee efficient administration and completeness.

Neither can it boast of accuracy of records, nor can it be a proof against fraudulent collusion especially on the part of those holding position of authority or trust. It is important to reiterate that the essence of having internal control systems in operation is to reduce the possibilities of errors and frauds in operation.

2.0  OBJECTIVE

At the end of this unit, you should be able to:

- explain the limitations/problems of internal control systems.

3.0  MAIN CONTENT

3.1  Limitations of Internal Control Systems

The limitations of internal control systems are as follows:

**Human Errors**

Where an official does an operation repeatedly over a period of time, stress and fatigue may set in sometimes with an attendant error being committed.
Collusion

Two or more officials may collude with one another, thereby, beating the control systems put in place by the client.

Abuse of Authority

A responsible official in a position of authority may abuse his powers to commit fraud.

Lack of Motivation

Where officials are not well compensated, they would not discharge their functions with integrity, thus creating an avenue for fraud.

It is important to point out that the essence of carrying out compliance test on an internal control system is to limit the auditor’s substantive testing. The auditor cannot rely solely on the operations of the internal control system as a basis for his opinion on the financial statement.

4.0 CONCLUSION

The problems of internal control systems are due to human errors collusion, abuse of authority, and lack of motivation.

5.0 SUMMARY

The problems faced by internal control system could also be seen as its limitations. These problems are: human errors, collusion between two or more officials thereby overriding the system, lack of motivation which may encourage fraud and abuse of authority by management.

6.0 TUTOR-MARKED ASSIGNMENT

List and explain the problems of internal control systems.

7.0 REFERENCES/FURTHER READING


MODULE 3

Unit 1  Internal Control of Stock in Hospitality Administration
Unit 2  Cash Disbursement Control in Hotel Management
Unit 3  Petty Cash Control in Hospitality Administration
Unit 4  Account Receivables Control in Hospitality Administration
Unit 5  Control of Employees’ Remuneration in Hospitality Administration

UNIT 1  INTERNAL CONTROL OF STOCK IN HOSPITALITY ADMINISTRATION

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Manual System of Stock Control
   3.2 Semi-Automated System of Stock Control
   3.3 Fully Automated System of Stock Control
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

As in nearly all hotel departments, food and beverages outlets of a hotel can operate under any of the three systems which are manual systems, semi-automated system and fully automated system.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- recognise the various system of stock control
- discuss how each system works.
3.0 MAIN CONTENT

3.1 Manual System of Stock Control

In small organisations where the manager or the owner is available in nearly all hotel operations, manual systems are preferred. This is because there is no need for an investment in computers, though a lot of human errors, as far as control is concerned, might be observed. The forms that must be used in a manual system are:

Captain Order

This form is a written format of the guest order. This is an internal control document prepared in three copies by the waiter/waitress. A copy is sent to kitchen for food production, a copy to service bar for the drinks to be prepared and the last copy to the cashier for opening a guest check. On the captain order, no monetary information is included. The order of the guest, the table no., the waiter ID, and number of guest(s) only filled. Captain orders help to control the relation between the waiter, kitchen, service bar and cashier.

Guest Check

By recording food and beverage item prices on the captain order, the cashier prepares the guest check. If any cancellations or an addition from the initial captain order occurs, the cashier should make the necessary changes. As far as payment is concerned, the guest might opt for: (i) Charging to his room: In this case, the waiter shall insert the room number and take the guest signature on the guest check, or (ii) cash, credit card, bank check or personal check. In this case, the waiter shall get the due amount from the guest; bring the collection to the cashier, who shall prepare the necessary legal document for sales along with the various internal control vouchers needed. In manual systems, cash register machine is used for this purpose. To illustrate, the cashier rings up the sale on the cash register and gives the guest the cash register bill.

At the end of his/her shift, the cashier should take the “Z” report from the cash register, attach it to various guest checks opened, the captain orders, and the total cash received in that very shift. Later, it is the responsibility of the hotel manager or accounting managers to verify the total shown on the cash register tape against the total cash receipts and the total computed from the serially numbered guest checks. While
doing so, the unit prices recorded on the guest checks have to also be verified from the price list.

3.2 Semi-Automated System of Stock Control

In larger organisations, maintaining internal control by observation and one to one verifications is not applicable. In cases where business owners want to benefit from computerised systems but cannot afford financially to set up a fully automated system, it is better to make use of an individual posting machine for the various F&B outlets' operations. In such systems, there is no need for the verification of unit prices on the guest checks as the computer automatically posts the prices.

The other advantage is, as the guest check printed from the posting machine is facing the legal requirements, there is no need to use cash register machine or to create another legal document. At the end of each shift, the cashier shall count the cash receipts and compare them with the total generated from guest checks. The accounting department does the verification. In semi-computerised accounting systems there is no interface with the other hotel departmental systems. This is one of the biggest disadvantages of this very system since it involves extra control work for other departments and functions. For example, the internal auditor must control and post all the data again to the front office system. This is time consuming and subject to numerous posting errors.

In practice, this might generate significant late charge amounts, and hence might affect seriously the financial position of the hotel.

3.3 Fully Automated System of Stock Control

In big organisations, manual or semi-automated systems cannot be applicable because of the huge amount of the number of transactions, their control, and the large amount of money associated to them. In fully automated systems, in order to maintain an adequate internal control and information flow, the individual computers must be electronically connected to each other. The major advantages of the system are: (i) online information is available; (ii) no need for re-entering data; and (iii) minimum internal control requirement.

4.0 CONCLUSION

The internal control of stock can be done by manual, semi-automated or fully automated systems.
5.0 SUMMARY

The internal control of stock in hospitality administration may be done using (i) manual system, (ii) semi-automated system, and (iii) fully automated system. While the manual is adopted in small organisations where the manager or the owner is available in nearly all the hotel operations, semi-automated system is adopted in larger organisations, in cases where business owners want to benefit from computerised systems but cannot afford the financial resources to set up a fully automated system.

Finally, the fully automated system is adopted in big organisations because of the huge amount of the number of transactions and the large amount of funds they require.

6.0 TUTOR-MARKED ASSIGNMENT

List and explain the various systems of internal control of stock.

7.0 REFERENCES/FURTHER READING


UNIT 2 CASH DISBURSEMENT CONTROL IN HOSPITALITY ADMINISTRATION

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Credit Control Procedures
   3.2 Cash Control
   3.3 Protection of Hotel Funds
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

The hotel industry is the only business where the guest enjoys the benefit of credit facility right from the time he comes to the hotel and where the business man whose primary objective is to collect revenue when the transaction is over is deprived of that and gets benefit only on or after the departure of the guest and that too sometimes after a period of 30-40 days in normal course. This results in the blocking of money and hence creates a situation of greater risk. It demands higher investment and hence it is important that the hotel takes some definite and concrete steps to ensure that the guest accounts will be settled in full at the agreed time therefore protecting the hotel from bankruptcy due to bad debts.

The hotel should control the credit of its guest to also ensure a healthy cash flow. Cash flow means the money which moves in and out of the business. The term credit control refers to the various measures taken by the hotel to ensure that the guests settle their accounts in full either themselves or through someone else on their behalf (which may be a credit card company, airline company, corporate office, a travel agent or person) within a specified period of time.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- write the credit control procedures
- discuss the cash control activities
- explain how to control hotel funds
- design the cash internal control chart in an hotel.
3.0 MAIN CONTENT

3.1 Credit Control Procedures

Various steps are to be taken by different front office personnel at different stages of the guest cycle that will help in credit control. Credit control procedures used for different guests at the front desk during check-in are:

(i) **Guest Paying by Credit Card**

A guest is required at the time of check-in to present his credit card

- Credit card is imprinted
- Name on the card is tallied with the name on registration card
- Check expiry date of the card
- Check the hotlist to check that it is not blacklisted
- Check that the hotel accepts the type of credit card presented by the guest

(ii) **Guest Paying by Travel Agent Voucher**

A Guest presents travel agents voucher at the time of check in. These are prepaid vouchers which are then tallied with the record copy the travel agent has sent to the hotel in advance at the time of reservation. The receptionist will then attach this voucher to the guest registration card and then send it to the cashier who will open the folio and mark the instruction as required on the folio.

(iii) **Guest Checking in with Tour Groups**

Groups are usually prearranged and preregistered and the credit procedure is established between the tour operator and the hotel prior to arrival. The cashier in such a case will open a master folio in case of group charges. The POS cashiers are informed not to make any credit sales transactions to any group member for their personal incidentals/expenses and charge cash for the same.

(iv) **Guests from Airlines**

There are two types of guests sent by the airlines:
Stay over Guests

These guests are provided with PSO {passenger service order} or MAO {meal and accommodation order} which details the services and facilities that will be provided by the hotel to such guests and the airline will pay for the same. The folio in this case will be signed by the guest at check out and the bill is forwarded to the airline company for payment.

Crew

These guests have to sign their bills on checkout which are forwarded to the airline for payment. Services and facilities which are provided by the hotel and paid for by the airline are mentioned in the contract which the airline makes with the hotel.

(v) Guests having all their Charges Billed

Look through the billing instructions given at the time of reservation to check what charges are covered by guests and what charges are paid by the company. If the room charges are to be billed to company and other incidentals are paid by the guest himself such as laundry, food etc. confirm with the guest at the time of check in itself how he will pay his incidentals and the same instruction must be marked on the folio. In such cases a split folio is used where charges are distributed into two {between company/organisation and individuals} one for rooms and the other for incidentals.

(vi) Guest with Scanty Baggage

These guests are not allowed to purchase anything on credit. All payments are to be settled in cash unless well known to the hotel. An advance/deposit is taken from them at the time of check-in to be adjusted against room and incidental charges. The registration cards, folio and arrival notification slips will have APC {All payments cash}. A credit limit is also fixed in case of well known guests with scanty baggage and the moment his outstanding balance reaches the limit the internal night auditor prepares a slip which tells the guest to deposit some cash before making any new credit transactions.

(vii) Walk-in/Chance Guests

To avoid any possibility of a skipper and hence loss of revenue, the hotel will usually ask for an advance payment or deposit at the time of check-in. The deposit should be enough to cover the room charges and incidental charges.
3.2 Cash Control

All cash must be kept under lock and key and under the supervision of the cashier. The cash/bank float given to the cashier is also controlled and a check is kept on the same.

The cashier should take proper precautions when dealing with foreign currency.

Whenever the guest pays in cash the cashier has to make a cash receipt and hand it over to the guest. The cash collected everyday should be sent to the bank for deposit. Cash control is important from the point of view of hotel as credit sales are usually discouraged.

3.3 Protection of Hotel Funds

- Cashiers should make frequent money drops to have minimum cash in hand.
- Cash drawers should be accessible to only one cashier at a time and should be kept closed when not in use
- Alarm systems should be installed in all areas of the hotel where cash transactions take place
- A consistent system for handling bank deposits and money pickup should be developed and followed.

Staff handling money like the cashier, security etc should be appointed only after strict scrutiny and cross checking with their previous employers. They should be rotated from time to time and a new combination of staff should be used. They must also be trained to react in emergency situations.
Cash Internal Control Chart

The Hotel issues House-banks to Cashiers ⇒ First Control Point

At the End of the Shift, each Cashier must prepare the "Cashier's Report"

Each Cashier must deposit the Envelope along with the Cashier's Report to the General Cashier's Safe Deposit Box ⇒ Second Control Point

The General Cashier must prepare the Daily General Cashier's Report

The General Cashier must deposit the Bank Accounts on a daily basis or on a weekly basis (Resort Hotels) ⇒ Third Control Point

The Income Auditor shall prepare the Journal Entry of Cash Transactions ⇒ Fourth Control Point

4.0 CONCLUSION

Cash disbursement control in hotel management can be done in three ways. This involves ensuring credit control procedures, cash control and protection of hotel funds.

The credit control procedures covers: guest paying by credit card, guest paying by travel agent voucher, guest checking in with tour groups, guests from airlines, guest with scanty baggage, and walk-in/chance guests.
5.0 SUMMARY

The credit control procedures involve guests paying by credit cards, travel agent voucher, guests checking in with tour groups, guest having all their charges billed guests with scanty baggage and walk-in guests.

As for cash control, all cash must be kept under lock and key and under the supervision of the cashier. The cashier should take proper precautions when dealing with foreign currencies. Whenever the guest pays in cash, the cashier has to make a cash receipt and hand it over to the guest. Cash control is important from the point of view of hotel, as credit sales are discouraged.

In protecting hotel funds, cashiers should make frequent drops to have minimum cash in hand, while cash drawers should be accessible to only one cashier at a time and should be kept closed when not in use. Also, alarm system should be installed in all areas of the hotel where cash transactions take place, and a consistent system for handling bank deposits and money pick up should be developed and followed.

To design effective controls around the hotel’s cash, a cash internal control chart which depicts four control points at which certain key control activities relating to cash handling are carried out.

6.0 TUTOR-MARKED ASSIGNMENT

i. Write short notes on the credit control procedures to be put in place for the following:

a) Guest paying by credit card
b) Guest paying by travel agent voucher
c) Guest checking in with tour groups
d) Guests from airlines
e) Guest with scanty baggage
f) Walk-in/chance guests

ii. What are the necessary steps to be taken for the protection of hotel funds?

iii. Draw and explain the cash internal control chart
7.0 REFERENCES/FURTHER READING


UNIT 3 PETTY CASH CONTROL IN HOSPITALITY ADMINISTRATION

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1.0 Introduction
2.0 Objective
2.0 Main Content
   3.1 Control Objectives of Petty Cash
   3.2 Detailed Controls of Petty Cash
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

Petty cash transactions are to be authorised accordance with established policies. Petty cash transactions are to be correctly analysed and recorded. The officer in charge of petty cash should not have access to other company funds. Petty cash should be maintained on an imprest basis.

2.0 OBJECTIVE

At the end of the unit, you should be able to:

- discuss the control objectives and the detailed controls of petty cash in hotel management.

3.0 MAIN CONTENT

3.1 Control Objectives of Petty Cash

The control objectives are to ensure that:

- All petty cash transactions are authorised bonafide and in accordance with established policies
- Petty cash is properly safeguarded
- Petty cash transactions are correctly analysed and recorded.
3.2 Detailed Controls of Petty Cash

The detailed controls of petty cash are:

- The officer in charge of petty cash should not have access to other company funds
- Petty cash should be maintained on an im-prest basis
- All petty cash payment must be properly authorised by a responsible person and must be in accordance with laid down policies
- All petty cash disbursements must be properly analysed and recorded in an analysed sheet
- Petty cash reimbursement should be made only after the petty cashier has properly accounted for all payments made during the period e.g. by supporting documents to duly authorised petty cash voucher
- Payment to suppliers involving material amounts should not be made out of the petty cash voucher fund and in any case policies should be established to ensure that the types of payments and the limits of their amounts are clearly communicated to the petty cashier
- Proper custody must be provided for petty cash voucher balances e.g. by the use of cash sales
- There should be a surprise cash count by an independent person e.g. the internal auditor. During the surprise cash count, the independent person should ensure that cash balance in the safe is in agreement with the record in the petty cash voucher book. In addition petty cash voucher should be examined for proper authorisation and to ensure that the transaction is in accordance with established policies
- Cash advance should be properly accounted for.

4.0 CONCLUSION

The control objectives and detailed controls are to be taken into consideration in the control of petty cash in hotel management.

5.0 SUMMARY

In designing suitably robust control around petty cash in hotel administration, all petty cash should be properly safeguarded, correctly analysed and recorded. The detailed controls of petty cash should take into consideration some factors, some of which include that the officer in charge of petty cash should not have access to other company’s funds. Petty cash should be maintained on an im-prest basis, with all cash
payments properly authorised by a responsible person in accordance with laid down policies.

Also, all petty cash disbursements must be properly analysed and recorded in an analysed sheet. Properly custody must be provided for petty cash voucher balance, while there should also be surprise cash count by an independent person. During the surprise cash count, the independent person should ensure that cash balance in the safe is in agreement with the record in the petty cash voucher book.

6.0 TUTOR-MARKED ASSIGNMENT

i. List three control objectives of petty cash in hotel management.
ii. Mention five detailed controls of petty cash in hotel management.

7.0 REFERENCES/FURTHER READING


UNIT 4 ACCOUNT RECEIVABLES CONTROL IN HOSPITALITY ADMINISTRATION

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      3.2.3 Compliance Risk
   3.3 Types of Accounts Receivables and Inventory Financing
4.0 Conclusion
5.0 Summary
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1.0 INTRODUCTION

Accounts receivable is an important asset of any business. Any delay or failure to collect due accounts, can result in cash flow shortages and profit erosion.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the necessary steps in the control of account receivables
- explain the risks involved in financing using account receivables
- identify the types of risks involved when financing with account receivables in hotel management.
- list the components of account receivables and inventory financing (ARIF) lending structures.

3.0 MAIN CONTENT

3.1 Account Receivables Control

The following are the controls to be taken into consideration.

- Ensure credit and collection policies are in writing
- Conduct credit checks on new credit customers
• Regularly age accounts and have an independent review of the report
• Ensure credit purchases are recorded as soon as the transaction occurs
• Separate the accounts receivable function and cash receipting
• Have transactions, such as non-cash credits and write-off of bad debts, cross-checked
• Review credit balances on a regular basis
• Have numerical or batch-processing controls over billing
• Ensure cross-checking of early payment discounts and penalties on overdue accounts
• Ensure mailing of accounts cannot be tampered with
• Prepare trial balance of individual accounts receivable regularly
• Reconcile trial balances with general ledger control accounts
• Have a well-documented and strict policy for the follow up of overdue accounts.

3.2 Risks of Accounts Receivable and Inventory Financing

From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on an organisation’s capital or earnings. The OCC has identified nine categories of risk: credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation. While accounts receivable and inventory financing (ARIF) have all these risks, this discussion/unit will focus on (i) credit, (ii) transaction, and (iii) compliance risks.

3.2.1 Credit Risk

Credit risk is the current and prospective risk to earnings or capital arising from a debtor’s failure to meet the terms of any contract with the organisation or otherwise to perform as agreed. Credit risk arises any time organisational funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Like other types of commercial lending, ARIF’s most significant risk is credit risk. ARIF borrowers typically exhibit higher default risk than other commercial borrowers. Credit risk is present in every part of the lending cycle — initial credit evaluation, underwriting, loan approval, loan administration, and, if necessary, debt liquidation.
3.2.2 Transaction Risk

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information.

3.2.3 Compliance Risk

Compliance risk is the risk to earnings or capital arising from violations of or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards.

3.3 Types of Accounts Receivables and Inventory Financing

There are various types of accounts receivables and inventory financing (ARIF) practised. Three categories are defined as follows:

(i) Blanket Receivables Lending

Asset-types other than accounts receivable and inventory that is often included in the collateral pool. Advances are not tied to borrowing-base formulas. Controls are minimal, and monitoring of the collateral is informal. Collateral valuations may be based on financial statements.

(ii) Factoring

This arises where lender purchases receivables outright, with or without recourse. Although any loan with a lien against current assets, such as a blanket receivables loan, is technically ARIF, here we are primarily concerned with arrangements in which lenders closely monitor and control collateral.

(iii) Accounts Receivable and Inventory Financing Structures

Since ARIF loans can be structured in many different ways, lenders should understand what structure is best suited to the characteristics of the borrower’s business. For example, should the loan be long-term or seasonal? Should it be “fully followed” or “desk-followed”? The purpose of the loan, the anticipated source of repayment, the creditworthiness of the borrower, and the cash operating cycle of the business will help determine the structure of an ARIF loan.

ARIF lenders will sometimes extend loans secured by fixed or other assets. They may even make unsecured loans. These loans may be separate agreements or part of complex “structured” loan agreements.
The term “structured finance” is used to describe an arrangement that has more than one layer or type of debt. ARIF lending structures commonly include revolving credit, permanent working capital, seasonal operating advances, over-advances, and term debt.

**Permanent Working Capital**

These are permanent working capital loans which fund business operations, new growth, acquisitions, and other general purposes.

**Seasonal Operating Advances**

For many businesses such as apparel manufacturers and retailers, demand is seasonal. At certain times of the year, they require additional working capital.

Before a peak-selling season, apparel manufacturers borrow to finish goods and build inventory levels. As inventory is sold, receivables increase until payments become due. Retailers often borrow to increase store inventory before heavy selling periods, such as holiday or tourist seasons, and repay after those seasons.

A borrower may also need temporary inventory financing when a key supplier offers a special promotion. “Seasonal” credit advances are tied to the operating cycle of the specific business, the product of the borrower, or both. Lenders can structure a seasonal operating advance as a single-maturity note or a sub-limit option within a revolver.

However, loans drawn under a revolver may not be specifically identified as seasonal. To distinguish the seasonal and “permanent” portions of a line, Auditors should perform an operating cycle analysis and review historical line; usage and repayment patterns.

Auditors should also review quarterly financial information to evaluate working asset account volumes and borrowing levels. For borrowers that expect to grow, lenders and auditors should review pro forma balance sheet and income statements. Significant deviation from pro forma usually warrants further analysis and may signal a potential problem.

Lenders expect borrowers to repay seasonal advances in full by the end of the seasonal business cycle, normally by converting the supporting collateral into cash. Failure to repay seasonal advances on time may indicate a significant credit weakness. To assess whether a credit weakness exists, auditors should review trends in the borrower’s sales
and profit margins; trade cycle trends, including trends in receivables, inventory, and payable turnover ratios; and overall operating cash flow relative to debt service and ongoing operating requirements.

Auditors should also determine the reason for any departure from historic borrowing patterns. If a borrower’s financial performance is clearly weak, the loan should receive an adverse risk rating, even if collateral protection seems adequate. Unless reversed, financial deterioration often decreases underlying collateral values and increases exposure to loss. Exceptions to an adverse rating should be rare and would be appropriate only when the collateral is of high quality and the debt is substantially below the borrowing base or the loan was advanced under bankruptcy approved DIP (debtor-in-possession) financing.

**Over-advances**

Over-advances are loan advances that exceed the borrowing base. Although over-advances normally have the same priority lien status as other loan advances, they represent increased credit risk because collateral protection is reduced. Like any other new extension of credit, an over-advance should be approved in accordance with the bank’s loan policies. Even when properly approved, frequent or longstanding over-advances are a sign of credit weakness. The credit approval documents of many ABL units and some secured lenders explicitly state when and under what conditions the lender will permit an over-advance. Such documents should stipulate the amount, frequency, duration, and period of the year when over-advances are permitted. Over-advances should be modest in amount and frequency; most important, they should have a defined repayment plan. Most lenders do not allow over-advances in excess of 10 percent of the borrowing base. Lenders should also do their best to verify that the borrower is using the proceeds as designated rather than masking obsolete inventory or slow sales. Lenders commonly permit over-advances for “Seasonal Inventory Buildup”, i.e. borrowers may have brief periods during their normal operating cycle when inventory buildup exceeds sales. In these situations, the lender may temporarily increase the inventory advance rate to accommodate an over-advance. For example, lawn and garden equipment manufacturers may require additional credit availability during the winter months when sales are slow and inventory is accumulated for spring shipments.

**4.0 CONCLUSION**

Including in the account receivables controls is to ensure that credit and collection policies are in writing, conducting of credit checks on new credit customers and regularly age accounts and have an independent
review of the report. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on a bank’s capital or earnings. Hotels are not also left out but the major risks of account receivables and inventory financing affecting them are credit risk, compliance risk, and transaction risk.

5.0 SUMMARY

Account receivable control should ensure that credit and collection policies are in writing, credit checks are conducted on new credit customers, perform aging analysis on a regular basis and have an independent review of the reports, amongst others.

Account receivable and inventory financing (ARIF) have nine categories of risks which are identified by the OCC. These are: credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic and reputation. ARIF’s most significant risk is credit risk.

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error and the inability to deliver products or services maintain a competitive position and manage information, while compliance risk is the risk to earnings or capital arising from violations of or non-conformance with laws, rules, and regulations, prescribed practices or ethical standards.

6.0 TUTOR-MARKED ASSIGNMENT

i. Mention five controls to be taken into consideration in account receivables.

ii. Explain three risks inherent in accounts receivable and inventory financing (ARIF).

iii. Mention three categories of accounts receivables and inventory financing (ARIF) lending.
7.0 REFERENCES/FURTHER READING


UNIT5  CONTROL OF EMPLOYEES’ REMUNERATION IN HOSPITALITY ADMINISTRATION

CONTENTS

1.0  Introduction
2.0  Objectives
3.0  Main Content
   3.1  Employees’ Remuneration Control
   3.2  Questions of Checklist about Employees of an Organisation
   3.3  Investigating Organisational Employees
   3.4  Ensuring Staff Feedback
4.0  Conclusion
5.0  Summary
6.0  Tutor-Marked Assignment
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1.0  INTRODUCTION

Control of employees’ remuneration can be done through the control of a good payroll system. Many payrolls, even small ones, are now automated, so it is easier to commit fraud or errors if the internal controls are not tight and the procedures are not set or followed.

2.0  OBJECTIVES

At the end of this unit, you should be able to:

- analyse the necessary steps in the control of employees’ remuneration
- design questions relating to an employee
- discuss more about your organisational employees
- explain how fraud is encouraged by staff in tipping off the auditors, owners or accountants of hospitality business.

3.0  MAIN CONTENT

3.1  Employees’ Remuneration Control

The steps to be taken into consideration when putting in place adequate control of employees’ remuneration are as follows:
• Ensure passwords are not handed to other staff members when the person in charge is on holiday or sick.
• If an electronic payroll is used, ensure supervisors change their password often
• Ensure any payroll summaries are in the same typeface as the system’s printer to avoid possible fraud
• Review bank account deposits to ensure that each pay goes to a different bank account
• Where possible, segregate payroll preparation, disbursement and distribution functions
• If possible, the payroll officers must not calculate their own pay.

3.2 Questions of Checklist about Employees of an Organisation

1. Are all employees hired by you?
2. Are individual personnel files maintained?
3. Is access to personnel files limited to you or a designated manager, who is independent of the payroll or cash functions?
4. Are wages, salaries, commission and piece rates approved by you, the owner?
5. Is proper authorisation obtained for payroll deductions?
6. Is gross pay determined using authorised rates and:
   (i) Adequate time records for employees paid by the hour?
   (ii) Piecework records for employees whose wages are based on production?
7. Are piecework records reconciled with sales records?
8. Are sales people’s commission records reconciled with sales records?
9. If employees punch time clocks, are the clocks located so they may be watched by someone in authority or are there security cameras in the vicinity?
10. Are time records for hourly employees approved by a supervisor?
11. Would you be aware of the absence of any employee?
12. Is the clerical accuracy of the payroll checked?
13. Are payroll registers reviewed by you?
14. Do you, the owner, approve, sign and distribute payroll cheques?
15. If employees are paid in cash, do you compare the cash requisition to the net payroll?
16. Do you maintain control over unclaimed payroll cheques?
17. Is annual leave required to be taken regularly?
3.3 Investigating Organisational Employees

In a small business, you are very reliant on your employees. They are your representatives with customers, suppliers and competitors. Take the time to hire the right persons/people for the job and your style of management, as the costs of hiring and training can be the equivalent to three months’ wages. This is not an easy process.

Unfortunately, some people do falsify their employment records to get a good job – it is more common than you think. When taking on a new employee, always take the time to check their employment record, ring the previous employers and don’t just rely on written references. Check out any claimed education credentials that are essential to the operation of the job/business, undertake regular annual performance reviews with staff, ensure adequate training is provided, clearly outline responsibilities and expectations, keep lines of communication open with employees by ensuring that:

1. Employees are well motivated because resentment increases when the owner enjoys success without passing it on to employees.
2. You are sensitive to employees’ hopes and expectations.
3. You don’t misplace trust – one person in a small business usually bears an inordinate amount of financial responsibility. Review your office staff.

3.4 Ensuring Staff Feedback

Finally, develop a process for staff to report breaches in internal controls and report suspicious behaviour. Ensure that staff know your door is always open and their concerns are welcome, not a nuisance. Most fraud is detected by staff tipping off the auditors, owners or accountants. This culture can be encouraged in organisations by:

1. Having in place a whistle blowing procedure
2. Protecting the identity of whistleblowers, if practicable
3. Protecting whistleblowers from being victimised
4. Investigating breaches as quickly as possible and taking firm disciplinary action when necessary
5. Rewarding staff for reporting breaches in internal controls or outright fraud (as well as for innovative ideas), perhaps with a gift voucher or similar, for every useable suggestion

It is important that staff feel that it is their duty and responsibility to report such matters as it is their livelihood, as well as yours, that relies upon the financial integrity of the business.
4.0 CONCLUSION

A good payroll system is a method through which employees’ remuneration can be controlled. In a small business, you are very reliant on your employees. They are your representatives with customers, suppliers and competitors. Take the time to hire the right person for the job and your style of management, as the costs of hiring and training can be the equivalent to three months’ wages. It is important to also let staff feel that it is their duty and responsibility to report/blow whistles as it is their livelihood, as well as yours, which relies upon the financial integrity of the business.

5.0 SUMMARY

One of the key steps to be taken when putting in place adequate control of employees’ remuneration is to ensure passwords are not handed to other staff members when the person in charge is on holiday or sick. If the hotel uses electronic payroll, ensure supervisors change their password often, ensure any payroll summaries are in the same typeface as the system’s printer and review bank account deposits to ensure that each goes to a different bank account.

Furthermore, to institute effective controls for employees’ remuneration, the following questions could come in handy in preparing a good checklist of what to do: (i) Are all employees hired by you? (ii) Are individual personnel files maintained? (iii) Are wages, salaries, commission and piece rates approved by you, the owner? (iv) Is proper authorisation obtained for payroll deductions? (v) Is access to personnel files limited to you or a designated manager, who is independent of the payroll or cash functions?

It is important to point out the fact that the workability of these controls depends, in part, on the ability of the organisation to hire the right people and demonstrate exceptional and inspiring management style. Hiring the right employees requires, among other things, to investigate previous employment records by ringing up the former employers, verify any claimed credentials and undertake regular annual performance reviews.

One other vital measure that could ensure the robustness of controls instituted around employees’ remuneration is to provide processes and mechanisms through which employees can provide feedback of whatever nature to the management. The management of a hospitality business could develop a process for staff to report breaches in internal controls and report suspicious behaviour, in addition to ensuring that staff know your door is always open and their concerns are welcome, not a nuisance.
6.0 TUTOR-MARKED ASSIGNMENT

i. List the necessary steps in the control of employees’ remuneration

ii. Write ten (10) questions to ask relating to the control of an employee.

iii. Mention four practices that are expected of staff in tipping off the auditors, owners or accountants of hospitality organisations.

7.0 REFERENCES/FURTHER READING


