

Solutions to Student Self Assessment Questions

Chapter 8

Systems work: basic ideas 2

Questions

8.1 Consider the following statements and explain why they may be true or false:

- (a) ICQs are questionnaires used to record the system in use.
- (b) ICQs are questionnaires used to evaluate the system in use.
- (c) ICEQs are questionnaires used to record the system in use.
- (d) The basic requirement of an accounting system is that it meets the needs of the business for which it is designed.
- (e) In a small organization it is impossible to have a good system of internal control.
- (f) In modern systems, a data flow diagram is more useful than a document flowchart.

8.2 Assume that Ann Paterson, an established customer, has telephoned asking that she be supplied with three recently published books. She has been passed to a sales clerk who deals with her order. Suggest controls that should be in force before her order is accepted.

8.3 Assuming that the order is accepted and that the books will be supplied on credit, explain what records will be affected by the transaction and the information/audit trail details that should be recorded.

8.4 In Table 8.2 we provided you with key and subsidiary questions in a sales system. Two key questions in a purchases system are:

- (a) Are all requisitions for goods and services initiated and approved by authorized responsible officials?
- (b) Are all purchase orders based on valid, authorized requisitions and are they processed in a manner to ensure that prices, conditions, quantity, quality and suppliers are appropriate to the business?

What subsidiary questions might you ask, assuming that in this system the order is automatically generated by the computer system?

Solutions

8.1 a) *True*

ICQs are questionnaires designed to help the auditor to understand how an accounting and internal control system operates, as well as aiding evaluation. They are not always useful in complex systems.

b) *True*

This statement is also true. ICQs are not merely used to record the operation of systems; they are also used to evaluate the systems. ICQs are usually designed so that 'No' answers will indicate a weakness in the systems in use.

c) *False*

ICEQs, unlike ICQs, are not used to **record** the systems in use, but to **evaluate** using key questions, supported by subsidiary questions.

d) *True*

Accounting systems do not have to be sophisticated if the demands of the business do not require it. In the case of a small trading company, it is possible that the only records required will be an analysed cash book and invoice and bank statement files. You should not forget that the more complicated the accounting system, the

greater the degree of expertise required to operate it. Many small businesses cannot afford to employ a trained accountant and rely on professional accountants to prepare financial statements for them.

e) *False*

While it is true that sound systems of internal check based upon segregation of duties is often not possible in small companies, the internal controls may be good because of supervisory controls exercised by proprietors or owner directors. There may be problems for the auditor, however, as there may be no certainty that directors are not overriding controls.

f) *True*

In modern computer systems many actions are occurring electronically within the company's systems, which do not result in a flow of documents, so it is more useful to show how data flows through the system. Auditors use the diagram to prove the audit trail and to identify control points. This does not mean that document flow charts do not have a role, as documents are still produced both before and after the computer.

8.2 As Ann Paterson is an established customer of the company, she would be able to identify herself and authenticate her status as a valued customer. She might already have given her credit card number and expiry date and an identifying word to the sales clerk before the order was processed. The clerk would either complete a hardcopy form or a form called up on the monitor screen. If the latter is the case, important controls would be (a) form design enabling easy completion (b) non-acceptance unless all fields on the form were complete. Further controls would be procedures to ensure that the clerk knows if the books are available and when they would be despatched, that calculated the amount of the invoice and compared Ann's credit limit with the outstanding balance, adjusted for the new transaction. The clerk would be prompted to inform Ann whether the order had been accepted, and if accepted, to read the terms of the order and amount of the invoice to her. The system should send a copy of the accepted order to her, and, if not accepted, a letter detailing reasons for non-acceptance. Further controls would be numbering of the orders processed by the sales clerk and the preparation of control totals for all transactions entered by the clerk during the day (the clerk would also need to be identified and authenticated). We would expect sequence checking of orders entered by the sales clerk. Apart from these controls the auditor would be interested in the completeness of the information/audit trail (see answer to 8. 3 below).

8.3 We made the assumption above that the sale was on credit. If so the following records would be affected by the transaction:

- (a) The transaction should give rise to hard copy documents - order form (numbered), despatch note (numbered) and sales invoice (numbered)
- (b) the following permanent records would be affected: sales transactions record (assuming that the company sells in its own name rather than on a commission basis); inventory record (assuming that this company keeps books on hand rather than having them supplied by a third party); debtors ledger for transaction and amended balance
- (c) the information audit trail should include the following features: customer name, identification word, authentication and credit card details; clerk and terminal handling the transactions; confirmation of inventory on hand requested by clerk; calculation of invoice; the sum of existing balance and transaction and comparison with credit limit; acceptance or non-acceptance of order together with reasons; record of order number; update of inventory record (and despatch note number) and debtors ledger (before and after balances in each case) and invoice details including number and duration of transaction.

8.4 In this system the requisition is the computerised trigger that results in an order being prepared. So we have to ask: 'Who decided that goods should be ordered in that quantity - who input the master file data of minimum reorder levels and reorder quantities. We would also ask whether minimum inventory levels and reorder quantities are reviewed at regular intervals and particularly when conditions change. Auditors would also wish to find out who decides which supplier is to supply the goods and who negotiates prices. This would lead to a number of subsidiary questions:

1. Is the person entering minimum inventory levels and reorder quantities on master files independent of the buying department, inventory room and computer operations?
2. Has that person received specific authorisation and is that authorisation checked at the time that the master files are updated?
3. Is the program tested from time to time to ensure that the trigger is operating properly?
4. Are minimum inventory levels and reorder quantities reviewed regularly to ensure that they are at the appropriate level?
5. Are suppliers' prices, terms and qualities of goods compared periodically with those of other suppliers by persons independent of the buying department to ensure that the company is supplied with the goods that they require at optimal terms?
6. Are statistics kept of suppliers selected and are enquiries made if some suppliers are favoured over others?

You may have suggested other questions, but these give a flavour of the kind of subsidiary question that would enable the key questions to be addressed.