JIT Couriers: Revenue system

JIT Couriers is one of the largest divisions of Diversico and operates a courier service for small and medium enterprises. To obtain audit evidence about the assertions relating to revenue and accounts receivable, you intend to place as much reliance as possible on the system of internal control for revenue.

Accordingly, your firm’s computer audit specialists have reviewed the general computer controls at JIT Couriers and have indicated that –

- the computer system operates on a wide area network that links all the computers at the regional depots to the head office;
- the general computer controls operated effectively throughout the 2009 financial year; and
- the software used by JIT Couriers was developed by a third party vendor and as such the source code is not accessible to the division. No program changes were made during the 2009 financial year.

JIT Couriers have provided you with the following description of the revenue system:

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<tr>
<th>Ref.</th>
<th>Procedures and controls</th>
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<tbody>
<tr>
<td>1</td>
<td>In all instances where specific employees are assigned to capture data, unique user IDs and passwords are used to ensure that only those employees are able to capture the data onto the computer system.</td>
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</table>
| 2    | Any small or medium enterprise that wishes to use the services of JIT Couriers is directed to the regional customer relationship manager, who requests and then inspects documents providing evidence of the enterprise’s address, ownership and statutory registration. After making copies of the documents, the customer relationship manager records the enterprise’s details and credit limit onto the customer master file.  
• An update summary, generated by the system, is given to the new customer who checks that the details are correct and signs it.  
• The signed update summary and the supporting documents are filed in a unique customer file.  
• The new customer is given the latest price list and a pack of uniquely pre-numbered, five-copy courier slips. |
| 3    | Whenever customers wish to use the services of JIT Couriers, they phone the call centre, quote a courier slip number and provide the name of a contact person. These data are captured onto the JIT Couriers logistics system by the call centre operator. Once the system has verified that the credit limit has not been exceeded, an instruction (containing customer data extracted from the customer master file) is
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<td>4</td>
<td>Before accepting the parcel from the customer, the courier checks the courier slip completed by the customer (for the destination details and type of delivery) to ensure all information is complete and legible. The courier then signs the courier slip as evidence of having checked the slip and having received the parcel, gives the top copy of the courier slip to the customer, attaches the remaining four copies to the parcel and transports the parcel to the regional depot. At the regional depot two copies of the courier slip remain affixed to the parcel, whilst one copy is given to the depot admin clerk and one to the depot operations clerk.</td>
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<tr>
<td>5</td>
<td>The depot admin clerk captures the pertinent details onto the invoicing system. Appropriate edit checks are performed on the captured data.</td>
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<td>6</td>
<td>The automated system processes the captured data, using the standing data in the pricing and customer masterfiles, and generates a sequentially numbered invoice.</td>
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<td>7</td>
<td>At the end of each day the invoice transaction file is used to update the revenue account in the general ledger and debtor’s account in the subsidiary ledger. The system makes use of run-to-run totals to ensure that the invoices for the day are correctly updated to the ledgers. The chief accountant reviews the run-to-run reports, and as evidence that he performed this review, signs the daily report.</td>
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<tr>
<td>8</td>
<td>Invoices are sent to customers after delivery. Monthly debtors’ statements are e-mailed to customers once per month.</td>
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<tr>
<td>9</td>
<td>The depot operations clerk uses the data from the depot operations copy of the courier slip to capture the pertinent data onto the logistics system. The logistics system determines the optimal routing of the parcel with reference to the destination address and type of delivery required (e.g. overnight or economy).</td>
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<tr>
<td>10</td>
<td>As the parcel is moved from depot to depot, it is tracked by means of the courier slip number, which is captured onto the logistics system at each depot. This system makes it possible to generate a tracking report on the location of the parcel at any point in time.</td>
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<tr>
<td>11</td>
<td>When the parcel is delivered to its final destination, the recipient is required to sign one of the remaining courier slip copies as evidence of having received the parcel. These details are captured by the depot admin clerk onto the logistics system upon return of the signed courier slip by the courier.</td>
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</table>

Your firm has data-interrogation software which can access the invoicing and logistics systems used by JIT Couriers, and you intend to make use of this to improve audit efficiency and effectiveness where necessary.
Corporation governance developments

Diversico is a widely held company. During the 2009 financial year, the board of directors of Diversico changed its corporate governance practices with a view to listing on the JSE Securities Exchange within the next two years.

Manco (Pty) Ltd (‘Manco’), a wholly-owned subsidiary of the Diversico group which houses the group’s administrative services, was accordingly tasked with the establishment of the Internal Audit Division. Mr Jack Jones was reassigned from the Finance Division to set up the Internal Audit Division at Manco. Management has requested that Manco’s Internal Audit Division assist the external auditors with the execution of some of their audit procedures. They are confident that the external auditors would be able to rely on the work performed by the Internal Audit Division in this regard.

Diversico also formed an audit committee, which comprises of three directors:

- Mr Arthur Andrews (chairperson) (independent non-executive director of Diversico);
- Mr Bill Bundy (financial director of Diversico); and
- Ms Cindy Cain (non-executive director and legal advisor of Diversico).

At its first meeting in July 2008, the audit committee ratified the appointment of Mr Jones as the head of the Internal Audit Division and approved an internal audit charter as well as the 2008/9 internal audit plan. The committee’s second meeting is scheduled for May 2009, during which it will deal with Inter alia the following matters:

- Nomination of ISA & Co for re-appointment as the company’s Registered Auditors for the 2010 financial year; and
- Consideration of the engagement of the nominated Registered Auditors to assist Diversico with improving its governance policies and procedures.

Internal audit: Example of audit work papers

Mr Jones provided the following audit work paper as a good example of the standard of the work performed by the Internal Audit Division. Mr Jones noted that as he is the only staff member in the Internal Audit Division, he is confident that the work performed is consistent with best practice and stated that he always prepares his work papers in accordance with the documentation requirements of the International Standards on Auditing.
Objective

To obtain sufficient appropriate audit evidence about EFT payments made.

Findings

Only the following three problems were found:

1. **EFT payment of R500 000 to Manco**: The only document that could be found supporting this payment was a one page instruction by the managing director of Diversico (who is also the executive chairman of Manco), dated 15 January 2009, to transfer R500 000 to Manco's bank account. The document indicated that this amount would be repaid as soon as the liquidity situation of Manco improved.

2. **EFT payment of R200 000 to Jumbo Suppliers Ltd**: Jumbo Suppliers Ltd is a major supplier of Diversico and at the end of February 2009 an amount of R1 500 000 was due and payable to this supplier. However, a note recorded on the creditors' reconciliation instructed that ‘due to cash flow constraints an amount of R200 000 should be paid – the supplier should be requested to supply signed delivery notes for the remainder of the invoices (as a tactic to delay payment)’.

3. **EFT payment of R75 000 to Mr V I Perty**: No documents were available to support this payment. Upon enquiry Mr Bundy (one of the payment approvers) indicated that this is a monthly payment made to Mr Perty to look after the interests of Diversico in the public sector. Mr Bundy cited a number of instances where Mr Perty's role proved decisive in securing government tenders.

Conclusion

Based on the work performed, and given the planning materiality figure of R1 million in the external audit plan, I am satisfied that EFT payments will not give rise to any material misstatement in the 2009 annual financial statements of Diversico.
**REQUIRED**

| (a) | With reference to the table of *Procedures and controls* of JIT Couriers and using the reference number to identify each control (rather than writing it out):
|     | (i) Identify the key controls over validity, completeness and accuracy of recorded revenue on which you would want to rely for audit purposes;
|     | (ii) Describe the control objective relating to revenue addressed by each key control identified in (i) with reference to the data and documents within the revenue system; and
|     | (iii) Describe a maximum of two audit procedures you would perform to test the operating effectiveness of each key control identified in (i). Detailed audit plans are not required.
|     | **Present your answer in a tabular format.**
| **Marks** | 24 |

| (b) | (i) Identify the internal control weaknesses in the revenue system of JIT Couriers, as set out in the table of *Procedures and controls*, which increase the risk of material misstatement pertaining to accounts receivable.
|     | (ii) For each weakness described in (i) –
|     |   · state the specific assertion(s) that are at risk;
|     |   · briefly describe the potential impact of the risk on the financial statements; and
|     |   · describe the nature of the audit procedures necessary to respond to the risk.
|     | **Present your answer in a tabular format.**
| **Marks** | 15 |

| (c) | Discuss, with reference to the information provided, any concerns you may have about relying on the work of the Internal Audit Division for the purposes of the 2009 audit of Diversico Ltd. Confine your answer to the following areas:
|     | · Organisational status;
|     | · Technical competence; and
|     | · Due professional care.
| **Marks** | 10 |

| (d) | Identify and discuss, based on the *findings* documented in the internal audit work paper, the risks of material misstatement that arise at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures for the 2009 audit of Diversico Ltd.
| **Marks** | 10 |

| (e) | Describe, solely with reference to the information provided, the matters that will have to be considered by your firm in deciding whether to accept re-appointment as the Registered Auditors of Diversico Ltd for the 2010 financial year.
| **Marks** | 6 |

**Presentation marks:** Arrangement and layout, clarity of explanation, logical argument and language usage.

| **Marks** | 5 |