

QUESTION TWO

FF Fashions Ltd is a small company which manufactures and sells high quality knitwear. Its customers are mainly fashion boutiques.

FF has two directors, one who is non-executive and the other who is involved in the day-to-day administration of the company. There are ten other employees. Six of these work in the factory, one works in the warehouse, one is a sales representative and two are accounts staff. The accounts staff consist of Miss Jones, who is responsible for processing sales and debtors, and Mrs Smith who is the purchases and wages clerk. Mrs Smith works part-time, five mornings a week.

The company's sales representative visits shops throughout the region. He takes orders from customers which he records on a pre-numbered two-part order form. He passes the completed forms to the accounts department. Miss Jones files one copy of the order form in numerical sequence and passes the other to the warehouse.

The completed order is despatched from the warehouse by carrier, accompanied by one copy of a despatch note. The other copy is sent to Miss Jones, who prepares an invoice based on the information it contains and on the company's price list. She sends one copy of the invoice to the customer, and a second copy of the invoice is retained.

Each Friday, Miss Jones inputs the week's invoices to the computerised sales ledger. She then files the invoices alphabetically by customer name. Despatch notes are not retained because filing space is limited.

Miss Jones opens the post daily and lists remittances received from credit customers. Every Friday, she inputs the information listed to the sales ledger. Cheques received are banked daily by the executive director.

Miss Jones reviews the sales ledger balances every month and writes to customers who have not paid within 90 days of receiving goods. The sales ledger is printed out annually for year-end purposes. Otherwise no hard copy is printed and Miss Jones reviews the sales ledger on the computer screen.

The company's computer package includes the facility to produce a sales day book and sales ledger control account. These are not used because Miss Jones considers that the low volume of transactions (10-15 invoices per week) makes them unnecessary.

Requirement

- a) Explain the particular issues relating to controls which would affect the audit of a small company such as FF Fashions Ltd
(10 marks)
- b) List six control objectives of a sales system.
(12 marks)
- c) State, with reasons, what you consider to be the potential deficiencies in FF Fashions Ltd's present system of accounting for sales and debtors.
(13 marks)

(TOTAL 35 MARKS)

QUESTION 2

(A)

The audit of a small company poses particular problems for an auditor for the following reasons:

- A single individual /small number of individuals running the business
- Lack of segregation of staff duties
- Few internal controls in place
- Informal controls that can be overridden by management

The company has 2 directors, one who is involved in the everyday running of the company. This means that internal controls can be overridden easily and may not be in place in any case. Although the other director is a non-executive, this individual may not feel confident in discussing any control issues, particularly if the director running the business is a strong individual.

It can also be seen that in the accounts department, there are only 2 members of staff so segregation of duties may not be possible – this also can result in fraud being easy to perpetrate.

In terms of the audit, this may mean that the auditor cannot rely on the internal controls in place, so would undertake a fully substantive audit consisting of tests of detail and analytical procedures.

(B)

Control objectives of a sales system:

- Goods and services are only supplied to customers with good credit ratings
- Customers are encouraged to pay promptly
- Orders are recorded correctly
- Orders are fulfilled
- All dispatches are recorded
- All goods and services are correctly invoiced
- All invoices raised relate to goods and service supplied by the business
- Credit notes are only issued for valid reasons
- All sales that have been invoiced are recorded in the accounting system
- All entries in the sales ledger are made to the correct accounts
- Potentially doubtful debts have been identified

(Only 6 are required)

(C)

Internal control deficiencies:

- 1 There does not appear to be any list of regular customers to be visited or timetable of regular visits

Reason

Potential sales may be lost if customer goodwill is lost through stock not being ordered promptly

- 2 There is no credit check for accepting an order

Reason

Goods may be issued to a bad credit risk

- 3 The order form has insufficient copies

Reason

The customer has no copy of the accepted order, disputes at a later date when the goods are despatched may become difficult to resolve

- 4 The order form is filed before being matched to a despatch note and sales invoice

Reason

Poor monitoring of accurate and timely completeness of sales orders

- 5 The copy of the order for use in the warehouse is not sent directly to the warehouse
Reason

The accounts department, who generate and post the sales invoice have the ability to adjust the order before it is sent to the warehouse

- 6 No copy of the despatch note is retained in the warehouse

Reason

No documentation is available within the warehouse to support stock movements and prepare stock records

7 The sales ledger is only updated weekly

Reason

Customers are being given an additional weeks credit which does not help cash flow

8 Mrs Jones has control over most stages of the sales cycle from passing the order to despatch, raising and posting the sales invoice to receiving and posting the cash

Reason

Sales transactions may be manipulated and company funds lost

9 Written debtor statements are only produced for balances over 90 days old

Reason

The company is giving a very long credit period before chasing for payment which could cause cash flow problems

10 There is no monthly reconciliation of a debtors listing to a control account balance. This is exacerbated by the fact that hard copies printouts of sales ledger balances are not retained

Reason

Errors in updating sales invoices and cash may go undetected until a customer complains. The lack of audit trail poses problems for the company in dealing with complaints but also in making year end provisions and providing audit evidence for the external auditor