

#### 14. OFFICE CONTROLS

Your uncle, who has been personnel director of Universal Life plc, a large insurance company, for as long as you can remember, has recently won £1.5 million on the football pools.

He telephones you thus:

'Following my good fortune, I have resigned from Universal Life and decided to become an entrepreneur.

I have just purchased a firm of insurance brokers that is a member of FIMBRA. The previous owner has had to retire after a mild heart attack, but he has not been heavily involved in its running for some time.

It has just the one office, but a good reputation and excellent staff. There are three sales persons, a secretary who does some of the book-keeping, and an office manageress who is also responsible for the accounting records.

Don't think that I am going to stop there. I want to build up to about twenty offices, and am already negotiating to purchase some of these.

I have got myself an accountant who is most useful on the financial side, but I would appreciate your advice on the accounting systems and controls side. I know these are vital because we had a lot of problems with brokers at Universal Life.

I realise I will have to get involved in my first office, but I want to keep this to a minimum.

As I expand, I anticipate setting up a central accounting department, probably in one of the offices with a bit of spare room, and that will obviously involve a complete shake-up.

Come and see me at the weekend.'

##### Requirements

- (a) Describe the problems your uncle is likely to encounter in adequately exercising control over his first office, and the principal internal controls that he should institute in his first office. (7 marks)
- (b) Indicate the principal internal controls, additional or different to those instituted in his first office, which he should expect to be operating when there are twenty offices and a central accounting department. (7 marks)

(14 marks)

## 14. OFFICE CONTROLS

### (a) Problems

#### *Lack of knowledge and experience*

As a personnel director of a large plc the uncle lacks knowledge and experience of managing a small firm. In particular, he lacks the systems knowledge required to ensure compliance with the regulations of the Financial Services Act imposed by FIMBRA. Also, he is more interested in negotiating his next acquisition than becoming involved in controlling the office's activities.

#### *Previous owner's absence*

Existing controls are likely to be lax as the office has been operating without supervision. It is possible that controls, which previously existed, have been circumvented eg. to save time or allow for the owner's absence.

#### *Size of firm*

The small number of staff severely limits the extent to which duties can be segregated. Also, the staff have been operating without owner involvement for some time and they may resent or be suspicious of the changes brought about by the new management.

#### **Principal internal controls**

*Organisation* - Although small, a plan is required to re-allocate and establish responsibilities and authorities between staff members.

*Segregation of duties* - Scope for segregation is extremely limited but, as far as possible, persons authorising transactions should not be responsible for recording them (and vice versa). For example, sales persons (who earn commission on new business) should not be responsible for entering new policies/cancellations in the records.

*Physical* - Access to client's monies, signed cheques, policies, investment documents etc. should be restricted to authorised persons eg. kept in safe deposit.

*Authorisation and approval* - Limits should be set on the staff's authority. Certain transactions should be authorised by the uncle eg. all cheque payments over a nominal sum, fixed asset additions and disposals.

*Arithmetic and accounting* - Documents should be pre-numbered where possible to facilitate sequence checks to ensure completeness. Control accounts should be maintained eg. for cash at bank, debtors, creditors and client monies and reconciled monthly.

*Personnel* - It is vital that staff members are capable of fulfilling their responsibilities. Additional training will need to be provided as operations expand.

*Supervision* - It is unlikely that the office manageress can supervise all the other staff on a daily basis. The uncle should make regular visits to authorise transactions, review reconciliations and monitor the activities of the office.

(b) **Principal internal controls**

*Organisation* - A detailed organisation chart should identify lines of reporting within each office and between offices and the central accounting department. Each office should have an appointed head. The chart should be supported by job descriptions to give staff a clear understanding of their duties and to whom they are responsible.

*Segregation of duties* - Recording of transactions and balances and the custody of most assets will be vested in the central accounting department whilst the execution of transaction will be at office level under the authorisation of office heads.

*Physical* - Access to each office and, in particular, the accounts department should be restricted to authorised personnel eg. using coded door-entry systems. Access to cash at bank will be Ltd through the careful selection of cheque signatories.

*Authorisation and approval* - Powers to authorise and approve transactions will be vested in appropriate persons eg. only directors may be cheque signatories, only office heads may authorise extending credit to customers etc. Different passwords should distinguish those entitled to enter new and cancel existing policies (head office staff) from those entitled to view policy details for reconciliation purposes (local office staff).

*Arithmetic and accounting* - Records kept at office and accounts department levels should be reconciled monthly. The accounts department will perform independent checks on information returned by the offices. A trial balance should be extracted monthly.

*Personnel* - The uncle should be responsible for recruiting new staff to the central accounts department and assess the training needs of staff acquired through new purchases. A 'code of conduct' should be established to ensure that staff appreciate the integrity which is commensurate with the provision of financial services.

*Supervision* - Day to day transactions will be supervised by office heads and a chief accountant responsible for the accounts department.

*Management* - It may be appropriate to establish an internal audit function to visit offices and ensure that Financial Services Rules are satisfied. A system of budgetary control may be developed which enables management to compare monthly management accounts with budgets across all offices.