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Systems and Controls

19 October 2017

Agenda



Internal Control

Systems

Internal Control Systems

Cycles

Questions

**AUDIT
RISK**

INHERENT RISK
X
CONTROL RISK
X
DETECTION RISK

Internal Control

Internal control

Internal control is:

- the process designed and effected by those charged with governance and other personnel
- to provide reasonable assurance about the achievement of the entity's objective

Internal control – continued

Internal controls are the mechanisms that clients design in an attempt to:

Prevent

Detect

Correct misstatement

The fundamental principle: **the stronger the control system the lower the risk of material misstatement** in the financial statements.

Systems

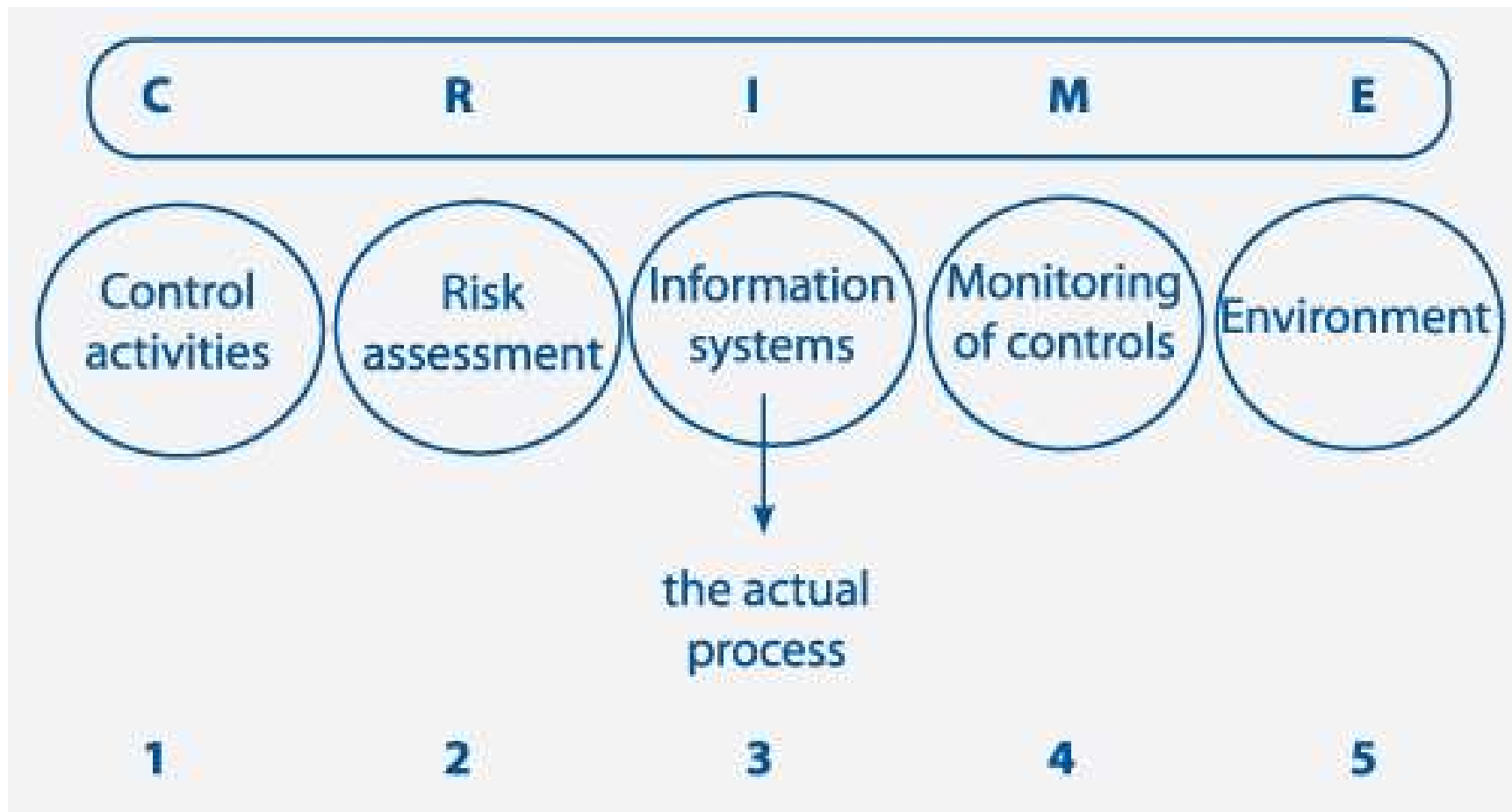
Types of systems

1 *Manual system*

2 *Computerised*

Internal control systems

The components of an internal control system



Control environment

The control environment consists of:

- Organisational structure
- Communication and enforcement of ethical values
- Participation by those charged with governance
- Management's philosophy and operating style
- Management need to have awareness
- Assignment of responsibility
- Human resource policies and practices

Internal control framework

COSO (Committee of Sponsoring Organizations of the Treadway Commission)

- Five components of internal control:
 - Control environment
 - Risk assessment
 - Control activities
 - Information and communication
 - Monitoring of controls

that need to be in place to achieve financial reporting and disclosure objectives

Control activities

Examples of Control activities

- Authorisation
- Performance review
- Information processing
- Physical controls
- Segregation of duties

IT controls

Application controls

- Preventative
- Detective

General controls

Application controls

- Arithmetic checks
- Range checks
- Validation checks
- Sequence checks
- Existence checks
- Authorisation of transaction entry
- Exception reporting

General controls

- Data centre and network operations
- System software acquisition
- Change and maintenance
- Access security – passwords, door locks, swipe cards, backup procedures

Monitoring of controls

- This is the process of assessing the effectiveness of controls over time and taking necessary remedial action.
- Responsibility of management

Obtaining evidence regarding the design and implementation

- enquiries of relevant personnel
- observing the application of controls
- tracing transactions through systems
- inspecting documents, such as internal procedure manuals

ISA 315 specifies that **enquiry, alone, is not sufficient** to understand the nature and extent of controls.

What if controls do not work?

Ineffective controls

- It may be more efficient and cost effective not to rely on controls at all as a source of assurance.
- It is possible that, even though the controls are not as effective as we would like, and the risk of misstatement may be increased, it may still be at an acceptable level.

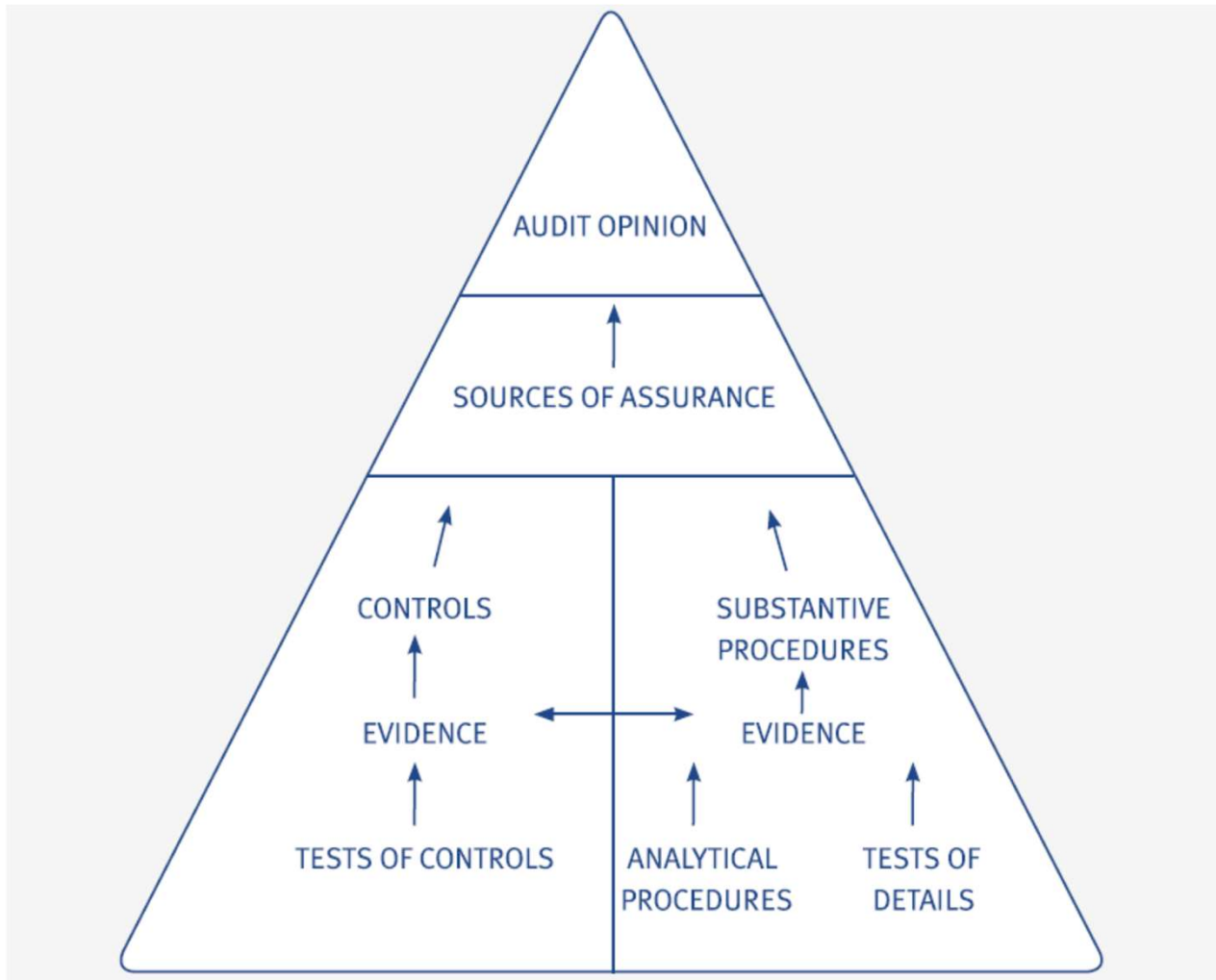
Alternative sources

- External confirmation
- Analytical procedures
- Management representations

Limitations of internal controls

The **need for substantive procedures** cannot be eliminated entirely due to inherent limitations to the reliance that can be placed on internal control.

The auditor must always perform substantive testing on material balances in the financial statements.



Control deficiencies and weaknesses

Auditors should communicate significant deficiencies in internal control in writing to ‘those charged with governance’

Structure

- Deficiency
- Consequence
- Recommendation

Cycles

Control cycles

- Revenue cycle
- Purchases cycle
- Payroll cycle
- Inventory cycle
- Capital expenditure cycle
- Cash cycle

Questions

Thank you for your attention.

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