

Name _____

1 Definition and explanation: What is internal control?

Internal means it is within itself, in other words, what can the management do within a business. Control means to have full authority something. Internal control in the business is what management can do to exercise authority over all activities within the business so that maximum profit can be obtained.

It is not only the managers/owners responsibility to have control over the business, but all employees have the responsibility. Everybody in a business must be involved in putting successful control measures in place.

To apply control, the following processes must be followed:

- Decide on short-term and long-term objectives.
- Gather information about the strong points and the shortcomings of the business.
- Analyse the strong points and the shortcomings of the business.
- Act against shortcomings.

2 Basic internal control processes

In order to maintain these processes, control must be kept over the following:

2.1 Stock control

- The place where goods are stored must be safe from natural disasters (rain, wind, etc.).
- The goods must be stored in such a way that the risk of burglary is minimised.
- All stock must be insured.
- Stock lists must be kept up-to-date.
- Sufficient stock must be kept, not too much or not too little.
- Documents must be completed for stock purchased.
- Documents must be completed for all stock issued to the sales department.
- Regular stocktaking must be done.
- The sales department must stay in contact with the warehouse to ensure enough stock is on the shelves.
- The sales department must keep track of how much stock is returned by clients, to ensure that the packaging used, is the best packaging. If necessary, alternative packing material must be used.
- It is important that orders placed by clients contain the correct stock and that it is correctly packaged.
- The purchasing department must look at the time of the year in order to keep the correct amount of stock. The time of year will have an effect on stock kept. (The Christmas season would need more stock than at other times of the year).
- If stock is kept too long, a sale may prevent possible losses.
- Separation of duties so that there is only one person involved with each activity. The more people are involved, the easier it is to point fingers. This prevents theft of stock by staff members, fraud and corruption.

2.2 Control over debtors

- Debtors must be selected carefully. Investigate whether they are creditworthy, etc.
- A complete record of transactions must be kept.
- Every debtor must have an individual account and the accounts must be kept up to date.
- Send out regular statements of accounts.
- Give discount to debtors who pay their accounts regularly.
- If a debtor's account is overdue for a certain period, interest on the account must be levied.
- Try to limit bad debts.

2.3 Control over creditors

It is important that the purchasing department to look at the following, if and when they decide on a supplier:

- Can the supplier provide goods on a regular basis?
- Does the supplier give trade discount?
- What is the supplier's payment period?
- Does the supplier give discount when accounts are paid on time?

All items that are received from a supplier must be accompanied by necessary documentation. The clerk at the warehouse must do the following:

- See that the goods on the invoice correspond with the items that have been delivered.
- Check whether any goods are damaged.
- If it happens that problems occur frequently with a supplier, an alternative supplier must be found.

2.4 Control over fixed assets

Fixed assets are purchased by the business for use in the business. Before any fixed assets are purchased, the purpose of the purchase must be investigated. Fixed assets consist of Land and buildings, vehicles and equipment. The internal control over each asset will be discussed.

2.4.1 Land and Buildings

Before the business is started, it must be decided whether the business will buy or rent a building. This will depend on the type of the business.

The following control must be kept over land and buildings:

- The building must be located in a place where the worth of the building will not decrease.
- The building must be maintained on a regular basis, so that no big expenses occur at a later stage.
- The building must be insured against natural disasters.

2.4.2 Vehicles

A proper investigation must be done to see what the needs of the business are and whether a vehicle will satisfy those needs.

The following control must be kept over vehicles:

- Write the depreciation off on vehicles at a rate and method that is suitable for the lifespan of the vehicle.
- Vehicles must be maintained.
- Look at technological changes and adapt accordingly.

2.4.3 Equipment

A proper investigation must be done to determine the purpose of the equipment.

The following control must be kept over equipment:

- Look at the lifespan of equipment and determine the method and rate at which depreciation will be written off.
- There are constant technological changes, e.g. computers. The business must remain up-to-date.
- Equipment must be maintained.

2.5 Control over consumable goods

Consumable goods consist of stationery, fuel and packing material. Control and management must be kept over these goods. A responsible person must be appointed to manage these items. This person's responsibilities are:

- to keep stock of all items.
- to keep sufficient stock of all items
- to record all purchases and goods issued.

2.6 Control over cash

Money is the means of exchange that is used to do business. Money takes on many forms: notes, coins, credit cards, cheques, etc. All participants must be well informed and they must know the responsibility that goes with handling money. The following journals are relevant to cash:

2.6.1 Cash Receipts Journal

The internal control for all cash receipts must make sure that cash being received is received by a responsible person and recorded in the books as soon as possible. It must also be deposited in the bank as soon as possible. The following procedures must be followed:

- a document must be issued for all cash received.
- Cash received must be recorded in the cash receipts journal.
- Cash must be kept in a safe place until it is deposited.
- Monthly bank statements must be checked so that changes in the books can be made – this is also a measure to see that there was no fraud.
- Separation of duties so that there is only one person involved with each activity. The more people are involved, the easier it is to point fingers. This prevents theft of stock by staff members, fraud and corruption.

2.6.2 Cash Payments Journal

All cash paid out must be done by cheque (excluding petty cash payments). Usually when a cheque is issued, two signatures are needed for safety reasons. The following are procedures that must be followed:

- All cheques that are issued must be kept in a safe place.
- All cheques issued must be entered in the Cash Payments Journal in consecutive numbers.
- Blank cheques must never be signed.
- At the end of the month, the Cash Payments Journal must be compared with the bank statement and all necessary corrections done - this is also a measure to see that there was no fraud.
- Separation of duties so that there is only one person involved with each activity. The more people are involved, the easier it is to point fingers. This prevents theft of stock by staff members, fraud and corruption.

2.6.3 Petty Cash Journal

A responsible person must be appointed to do the petty cash payments. Petty cash payments are small amounts that are paid. The following procedures must be followed:

- The petty cash must be kept in a locked petty cash box and kept in a safe place.
- Petty cash payments must be recorded in the Petty Cash Journal.
- As far as possible two people has to sign for any petty cash payments.
- As far as possible an external document must be attached to the petty cash voucher.

Important:

- These internal control measures will be integrated with all the topics and will continuously be assessed as we advance with the Study Guide.
- Make sure you understand all the internal control measures.
- Don't try to study all the internal control measures all at once. Study two or three and make sure that you can apply it before you attempt to study more.
- When you answer questions on internal control measures, try to pretend that you are working in the business to apply the measures that you have learnt. Think logically.

Activity 1 (Internal control)

Moses Mngadi has a delivery service business called MM Deliveries. He has five drivers who deliver orders for businesses to customers. Some drivers also run personal errands with the business transport. This increases fuel cost and risks of theft and damage for Moses' business. Suggest which control measures Moses can put in place to save on expenses and also reduce risk.

