

# PRACTICE ASSESSMENT

## Internal control and accounting systems AAT Level 4 Diploma in Accounting

### Assessment book

#### Candidate

- This **practice assessment** is for familiarisation purposes only and **must not** be used in place of a 'live' assessment.
- When you feel prepared to sit the live assessment please contact your Training Provider who can schedule a live assessment for you.

## Bayou Stores Limited

**This sample case study is intended to indicate the type of situation that candidates will be presented with, and as such should be considered as an abridged version of those that will actually be used for live assessments.**

Bayou Stores Ltd. is a large wholesale warehouse supplying a range of groceries, cleaning materials and other household goods to small, independent grocery stores. It was set up in 2008 by John Bayou, who having taken early retirement from his job as a fire fighter, used his pension and an inheritance to set up the business on the edge of Grantchester, a large industrial city. Besides the warehouse, John, who is single, has only one hobby, which is golf. He usually spends all day Friday at the golf club – and, other than this, he works very long hours for the other six days a week.

He employs 30 staff in the stores and three part-time staff in the small accounts department. You have just been employed to work as the senior accounts clerk and, as the only full-time staff member, to supervise the running of the office. The store is open seven days a week, and operates from 7am until 10pm, Monday to Friday and from 10am to 6pm on Saturday and Sunday, whilst the accounts department only opens from 9am until 5pm Monday to Friday.

The accounts department's office is located on the first floor, over the warehouse store, which occupies the whole of the ground floor of the building. Access to the office is by stairs or an elevator from the ground floor – and this access is often used by the public – as the toilet facilities for staff and customers are also located on the first floor. Once on this floor access to the accounts office is gained through a keypad code, the code for which is UOYAB (Bayou read backwards). This code is relatively common knowledge throughout the company as it is also the alarm code for the building, and is used by the warehouse store supervisors and manager when they close up in the evenings.

Once inside the accounts office the working area is open plan, and anyone inside has full access to all the working areas.

The first job John has asked you to do is to review the accounting system and particularly the effectiveness of its internal controls. You are then asked to make any recommendations for improvements which you feel are necessary. John knows there are many weaknesses – but is uncertain as to how these should be managed.

To help you in this he has asked the accounts clerks to prepare some brief information about themselves, an overview of the accounting system and also a list of events that have occurred over the previous few months. This information can be found on the next page.

**The current staff in the accounting office are as follows:**

**Jo Doyle (Wages Clerk)**

Jo is 24 years old and has been working for the company for four months. She is employed as a wages clerk and prepares the wages and salaries for all staff, along with all the associated returns, on a two day a week basis on a Wednesday and Thursday each week. She has a young child, Harry, who is three years old, and spends all her free time with him. Though she is willing to work some extra hours if needed, she does not want to commit herself to any more permanent hours, as she would need to rearrange her child care. Jo gained her AAT NVQ level 2 in payroll four years ago but has never progressed any further since due to the arrival of Harry.

**Gary Idawo (Accounts Clerk)**

Gary is eighteen years old and has been working for Bayou Stores for just a year since he left the local 6<sup>th</sup> form college with three GCSE Advanced 'A' levels, including one in accounting. His main responsibilities are as the accounts receivable (sales ledger) clerk and his duties include running all the trade credit accounts for the company. He works four days a week – and has chosen not to work on a Friday. This is because his main hobby is music, and he plays in a band every weekend – and Friday is his rehearsal day. He has had no formal accounting training, but was trained on-the-job by the previous accounts receivable clerk before she left the company. He has, however, expressed an interest in learning, and wants to increase his accounting skills but is uncertain about how to go about this.

**Marion Smith (Accounts Clerk)**

Marion is 57 years old and she has been employed at Bayou Stores for eight months. She has recently been widowed and decided she needed to return to work to supplement her income. Her main role is that of accounts payable (purchase ledger) clerk. She is employed on a part-time basis of five half days per week, and she often likes to work these together to save on her bus fares to work. So for the past few months she has been working all day Tuesday and Wednesday and a half- day on Thursday morning. She has several years experience in operating accounting systems, but has not worked in this area for over ten years, since she left her last role to care for her sick husband.

**The current accounting office practices and systems are outlined on page 4 to 8 inclusive**

### **Information technology systems**

There are three computers in the office, as John has provided one for every member of the accounts team. These are all run on a stand-alone basis, though they are all linked to the same printer. Since John had some knowledge of Microsoft Office Excel spreadsheets whilst he was in the fire brigade (as they use this as their inventory control system) – he has based the inventory system for Bayou Stores on this same method and because of this the wider accounting system is also being run using Excel.

Two computers were purchased new when the company was established and are running on Windows Vista operating system; they are also loaded with Microsoft Office 2007 version (with a three user licence). Six months ago a further new computer was also purchased and loaded with Sage Payroll software to enable the payroll to be run in-house.

When the computer system was set-up a password was installed to protect the work. This is also UOYAB, as John uses the same security code for everything throughout the company because he feels this makes life easier.

## Wages and salaries

Until six months ago the payroll was completed by the company accountants, Pearl & Johnson. However, this was beginning to become very costly, as the individual hours worked each week by staff are so variable that the payroll run was different every week, and the accountants charged for the time taken to complete this. John made the decision that the wages and salaries could be run in-house. For the first two months, he used a temping agency (but again this was an expensive option) to operate this, until four months ago, when Jo started working for the company.

All store staff are paid weekly, in cash, and pay packets are available from the store manager from 8am on a Friday morning. The office staff and store manager are paid monthly, by cheque, on the last working day of each month. Store staff are paid a basic rate of £7 per hour for the first 40 hours worked and time and a half for any hours over this from Monday to Saturday. Any hours worked on a Sunday are paid at double time. The store supervisors, of whom there are four, are also paid the same overtime premiums but based on a basic rate of £9 an hour.

The supervisors are responsible for preparing staff rotas for their own departments to ensure that there is adequate staff coverage for all of the opening hours. Most of the warehouse staff are willing to work overtime, so this does not usually create any problems. Once the week has finished, the completed rotas are given to Jo who uses them to calculate the amount of hours that the individual store staff have worked.

Jo prepares the payslips from this information on a Wednesday, calculating manually any overtime payments due, and any Sunday working. From this, she calculates how much cash needs to be drawn from the bank and uses the company cheque book (which is kept locked in Marion's desk) to prepare a cheque ready for John's signature. On a Thursday she then prepares the pay packets, which are stored in the office safe for the store manager to collect, (though often it is the supervisors who actually do this), and to hand out to the staff the following day. Any pay packets not given out are returned to the office safe and remain there until collected by the relevant member of staff.

Only Statutory Sick Pay (SSP) is paid to the warehouse store staff, but the office staff are salaried and are allowed four weeks contractual sick pay per year.

John has always trusted his workforce completely and there is no requirement, or system in place, for either store or office employees to sign in when they arrive or leave work.

**Accounts Payable (Purchase Ledger)**

All inventory is purchased on credit terms from a very wide range of suppliers. This is John's main role and he does enjoy spending time researching new inventory lines, and also meeting the sales staff from different suppliers. He has a favourite group of suppliers he tends to use, mainly because the sales staff from these treat him to an occasional game of golf.

All inventory levels are maintained on the Excel spreadsheets. These have been set up to show suppliers, cost prices, selling prices, profit margins, and re-order levels and quantities. Marion has worked on Excel previously, but this was over ten years ago and whilst she is competent at inputting data, she sometimes struggles with anything beyond this.

Suppliers are paid at the end of the month that their invoice is received, as long as funds are available. However, due to the current credit crunch some suppliers are now beginning to request payment earlier, within thirty days of the date of invoice, and this is beginning to cause John some concern.

All suppliers are paid by cheque. These are completed by Marion, and the only authorised signatory is John. The cheque book is stored in a locked drawer in Marion's desk in the accounts office.

**Accounts Receivable (Sales Ledger)**

Gary is responsible for the running of this function. Whilst many customers pay cash for their goods, over fifty per cent take extended credit terms. When Gary first started at Bayou Stores, anyone who applied for a credit account was accepted. However, he realised that this was not good practice and he now uses a credit reference agency to ensure that potential new credit customers have no history of poor payments. Other than this check any new customer who applied is automatically granted an unlimited line of credit.

All new credit accounts are set up on the first day of the month and Gary often works extra hours on this day to ensure this task is completed. All sales orders are received by the warehouse store staff for processing and, after completion, are passed to the accounts department the next morning, so that Gary can prepare the invoices and enter these in the accounts. Gary has designed a form in Microsoft Office Word which he uses as a pro forma for invoicing.

Bayou Stores offers sixty days credit to all their customers, and Gary is responsible for ensuring payment occurs. The policy on this is that once payment is seven days overdue Gary will telephone the customer. If payment is not received within seven days of the telephone call, then a 'stop' will be placed on the account and that customer is then not allowed any more goods or credit until payment has been made for any invoices more than sixty days old.

Gary allows two half days per month for the task of telephoning customers who are late in paying; drawing the information from an aged trade receivables control listing which has been set up on the Excel system to indicate customers whose accounts are outstanding for more than sixty days.

**Cash and banking**

Gary opens the mail every morning and sorts through it. Any cash or cheques received from customers are entered manually into a day book to record the receipt, which is then used to update the accounts. The cheques and cash are then placed in the office safe until a banking day.

At the end of every day, all cash and cheques are removed from the tills, leaving a float of £100 cash in each till for the start of the next day. The principle is that the till should be balanced to ensure that the cash content is correct, but during the week this does not happen as the store closes at 10pm, and the supervisors feel that they should not be asked to do an extra job at this time of the evening. Therefore, common practice is that all cash (except for the till floats) and cheques are removed and bagged as takings from individual tills before being stored in the safe in the accounts office.

Banking is carried out on a Monday and Thursday, and this is normally Gary's job which he does during his lunch break. The Thursday banking of cash is often lower as John has now started to reduce the cheques drawn for wages by the amount of cash available in the office safe on a Thursday morning. His idea is that any cash available can be used to supplement the making up of the wages to reduce the amount of cash needed to be drawn from the bank.

There is no petty cash system as such. If cash is needed for any incidental expenses, this is taken from the till floats and a note put in the till to cover this.



## Diary of events for the last three months

### October 2009

One Tuesday, David Singh, a worker from the warehouse store, who has been off ill for five days, came into the office to collect his wages for the previous week, which he had not received due to his illness. His supervisor sent him upstairs to the accounts office, but even after a thorough search of the office safe, and then the office itself, the pay packet could not be found.

David was naturally annoyed at this and Gary tried to help. As Jo was not at work that day, and no one else could operate the Sage payroll system, it was not known how much David was owed. Gary decided that the rota said David was due to work 45 hours that week and so calculated his pay accordingly as:

35 x £7 plus 5 x £14 (Sunday working) plus 5 x £10.50 for overtime. Therefore, he thought David was due £367.50 – so he gave him this amount of cash from the safe.

Later in the month Gary caught flu and was off work ill for two weeks. He therefore did no credit control work during this time. Marion worked one day extra a week to cover his work – but could not manipulate the data, or access the pivot table on the Excel spreadsheet that Gary uses to highlight outstanding payments.

In an unheard of incident John has taken the last five days of the month off to attend a golfing tournament he has been invited to by a supplier. However, this was a last minute invitation and he only informed the accounts staff by telephone as he was on his way to the airport. He knew that he would need to pay suppliers during this time, and also staff wages, so he went to the office at 6am and signed a cheque book full of blank cheques to cover this. He had taken his spare keys with him, so was surprised when he discovered Marion's desk drawers unlocked.

On the last Friday of the month, Marion called into the office to pick up her salary cheque. As no one was about, and she knew that Jo had prepared these earlier in the week, she helped herself to this from Jo's desk drawer.

### November 2009

John told the accounts staff that after a telephone conversation with the bank manager he was very concerned over the size of the company overdraft and he had been informed that this must be reduced over the next four months.

He sat down with Gary to review the amounts owed by customers and was surprised to discover that more than twenty small retailers, who all are very good customers, owed more than £75,000 each. It became clear that they all take advantage of the full sixty day credit terms given by Bayou Stores and only make the minimum payment due, at the very end of this period. During this meeting Gary asked John about undertaking some accounts training, and John says he was very happy for him to do this, and would be willing to pay for it, if Gary could locate a suitable course.

On the first Monday in the month an irate supplier again telephoned the accounts office regarding late payments, and threatening to withdraw Bayou Stores credit facility. As Marion was not at work, Gary took the call and promised the supplier that the cheque would be in the mail that evening. He knew where the cheque book was kept, and that the drawer was often left unlocked; he thought he could complete the cheque and ask John to sign it and send it to the supplier immediately. However, he discovered that there was still a blank cheque which had already been signed by John during his golfing break, so he completed this and mailed it to the supplier to ensure they are satisfied. He was subsequently busy that week and so forgot to inform Marion of his actions – and as each accounts staff member only normally works on their own computer, he did not update the accounts payable system.

On the second Friday in the month the telephone in the accounts department was ringing incessantly. At lunch time Stevan Teery, a warehouse store supervisor, went into the accounts office to answer it only to hear from a credit controller in a supplier company who was chasing up an invoice that had not been paid within their thirty day terms. Stevan could only try and placate the supplier, and take a message for the accounts office staff. The following week, five warehouse staff complained to Jo that their wages were wrong. They had been asked to work extra hours to cover staff sickness, but this had not been marked on the rota sheets, and therefore they had been underpaid for the extra hours they worked. Equally it meant that the two staff who were off ill, had been overpaid for these hours but they had not reported this to the accounts department.

### **December 2009**

Jo had booked two weeks holiday over Christmas, as she wanted to spend this time with Harry. As she knew that she is the only member of staff who can operate the Sage payroll system she decided to complete three weeks pay packets on the same date – all based on the hours worked in the current week. She completed the pay packets and placed them in the safe, informing the supervisors that Gary will give them out on the correct Friday and that any over or under payments will be adjusted during the following week after she has returned to work.

On the last Monday in the month a warehouse store worker, Matthew Perkins, came into the office to complain. Unbeknown to the other warehouse store staff he was having matrimonial problems, had recently left his wife to live with his girlfriend, and had taken a few days holiday last week for this move. His wife was aware that he was on holiday and had turned up at Bayou Stores and asked the supervisor for his pay packet saying that he was too busy to call in for it. As the supervisor knew his wife, (he had met her with Matthew at the staff Christmas party last year) he had handed her Matthew's pay packet without question, leaving Matthew with no money for the week.

## Tasks

Complete a business report to John Bayou. This should be approximately 3500 - 4000 words long, and should cover the following tasks:

### Task 1

#### **Complete a review of the accounting system**

This can be of the complete system or of one or more of the accounting functions, depending on your findings, but must specifically cover the following areas:

- (a)** Record keeping systems - the purpose of financial reports, and the suitability of the organisation's current reports to meet organisational needs. (EAS 1.2 & PIC1.2)
- (b)** Internal systems of control - identify how internal control supports the accounting system and the types of internal control in place, and any controls that are missing. (PIC2.4, PIC3.2 & EAS 1.4)
- (c)** Fraud - causes of fraud, common types of fraud, methods used to detect fraud and potential areas for fraud within the organisation. (EAS 1.4, PIC2.2 & PIC2.3, PIC 3.1)
- (d)** Working methods/practices - including the use of appropriate computer software, and the operating methods in terms of reliability, speed and cost effectiveness. (PIC 3.4 & EAS 1.5)
- (e)** Training (PIC 3.3) - Identify how training is or can be used to support staff.

The review should cover all aspects of the assessment criteria, as mapped above, when it can naturally be introduced into the report. If it cannot be covered in the report then it can be covered within a written explanation included in the appendix.

Whilst a SWOT analysis may be a good starting place, this should not be placed in the body of the report.

## Task 2

### Identify weaknesses and make recommendations for improvement

- Once the review of the system has been completed, the weaknesses that have been identified should be clearly explained along with their impact upon the organisation.  
(EAS 1.3 & PIC 3.1).
- For every weakness that has been identified there should be a recommendation made to attempt to improve the situation. (EAS 2.1 & PIC 2.4 & PIC 3.2)

The recommendations should concentrate on the effect that the changes would have both on the organisation and on individual members of staff (EAS 2.2 & PIC 1.5). They may also highlight training needs or aids to improve staff performance (EAS 2.3 & PIC 3.3).

## Task 3

### Prepare a cost benefit analysis

- At least one of the recommendations made should be subject to a cost benefit analysis. Whilst not all benefits are quantifiable, all costs are and students should make any necessary assumptions or 'guesstimates' to allocate costs to such items as time, unknown salaries, or any other unknown expense involved in the recommended changes.
- All benefits should be identified, included those which cannot be allocated a financial figure. This can include such things as improved customer relationships, improved documentation systems or staff morale (though this could be allocated a financial benefit as improving staff turnover cuts recruitment costs).  
(EAS2.4)

### Note on Appendices

Any charts and diagrams or supporting evidence should be included here and cross-referenced within the text. Any appendices included should be referred to in the main body of the report or, in the case of supporting statements to cover missing assessment criteria, mapped and cross-referenced to a copy of the unit standards.