

# **INTERNAL ACCOUNTING SYSTEMS AND CONTROLS**

## **STUDY TEXT**

### **Qualifications and Credit Framework**

**Q2022**

The Study Text supports study for the following AAT qualifications:

AAT Level 4 Diploma in Professional Accounting

AAT Diploma in Professional Accounting at SCQF Level 8

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## STUDY TEXT

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# INTRODUCTION

## HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

## STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in 2022.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

### ICONS

The chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



#### Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



#### Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



#### Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.



#### Foundation activities

These are questions to help ground your knowledge and consolidate your understanding on areas you're finding tricky.



#### Extension activities

These questions are for if you're feeling confident or wish to develop your higher level skills.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

# The accounting function

## Introduction

The accounting function is an important part of any organisation. It needs to reflect the organisation's needs at all times.

### PERFORMANCE CRITERIA

1.1 The accounting function

### CONTENTS

- 1 Introduction
- 2 The accounting/finance function
- 3 Understanding systems

# 1 Introduction

## 1.1 Organisations and the need for control

There are many different types of organisations but they all share the following key characteristics:



### Definition

'Organisations are social arrangements for the controlled performance of collective goals'.

The key aspects of this definition are:

- **Collective goals** – organisations are defined primarily by their goals. A school has the main goal of educating pupils and will be organised differently from a company where the main objectives are to make profits and pay dividends to shareholders.
- **Social arrangements** – someone working on their own does not constitute an organisation. Organisations have structure to enable people to work together towards common goals.
- **Controlled performance** – organisations have systems or procedures to ensure goals are achieved.

In this unit we will focus on the third of these:

- How do organisations ensure that they achieve their objectives?
- What control mechanisms can they introduce to help managers and other employees work in such a way that the organisation is successful?

## 1.2 Control mechanisms

There are a number of types of control which can be used within an organisation, including the following:

- Organisational **structure** – breaking the organisation down into smaller units, such as a dedicated accounts department, with clearly defined roles, responsibilities and authority. This can be reflected in many ways, for example, insisting that all capital expenditure over £1,000 must be authorised by the Finance Director.
- **Target setting and budgeting** – so that employees are aware of what is expected of them.
- Direct **supervision** of employees by managers.

- The **culture** of the organisation – for example, where mistakes are not tolerated.
- **Self-control** where employees are encouraged to work independently and take responsibility for their own results.
- Control **systems** – for example where actual results are compared to the budget each month and variances calculated. These allow managers to identify, and focus on, areas where performance is not as expected and take corrective action.
- Specific control **processes** – for example, purchase ledger control account reconciliations may identify errors in processing purchase invoices. Note: the purchase ledger control account can also be known as the payables ledger control account.

In this chapter, and the Chapters that follow, we shall look in particular at how some of these impact the running of the accounting function and the role of internal controls within an accounting system.



### Test your understanding 1

Jersey Ltd is a small business that manufactures high quality portable loudspeakers. The business is small and has only twenty members of staff, with one supervisor. The work is highly skilled and complex, with staff divided into four teams – each with very different sets of required skills.

Currently there are no control procedures or any work guidance for employees, meaning that each member of staff often works in the way they individually feel is best. The twenty employees are moderately well paid, though there are few, if any, real promotion prospects and several employees have expressed their dissatisfaction with the working conditions within Jersey.

Jersey is owned and run by one person, H. H is concerned that the quality of production has fallen in recent months, as evidenced by an increase in wastage and a decrease in output. H is concerned about the effect this is having on the profitability of the company. As such, H is examining the possibility of introducing control processes to ensure that all units produced are of adequate quality.

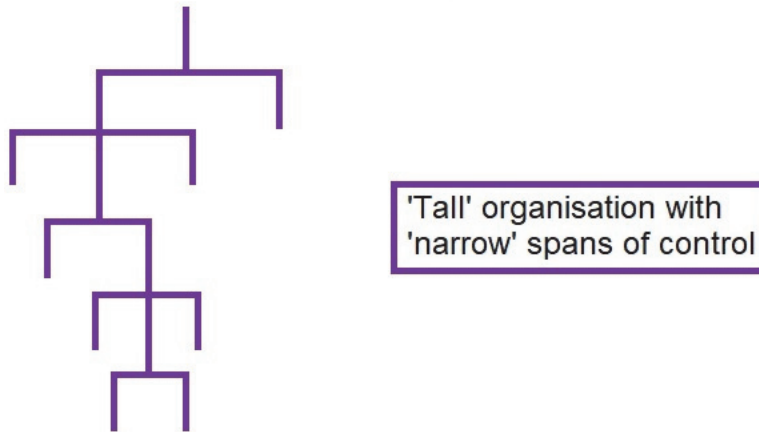
#### Task

Discuss the appropriateness of each of the following possible controls for Jersey:

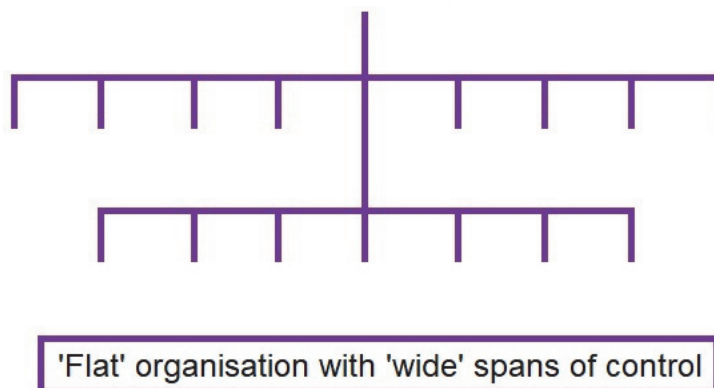
- (a) Direct supervision of manufacturing staff
- (b) Setting performance targets for employees based on quality of output
- (c) Relying on individual employees to control their own work.

### Tall and flat organisations

Tall organisations have many 'layers' of management, who oversee relatively few subordinates.



Flat organisations have few layers of management, who oversee a larger number of subordinates.



In order to discuss these issues, it is important to distinguish between authority, responsibility and accountability:

- **Authority:** if an organisation is to function as a co-operative system of individuals, some people must have authority or power over others. Authority and power flow downwards through the formal organisation.
- **Responsibility:** tasks may be allocated to individuals and groups within the organisation, and those individuals or groups are responsible completing those tasks. It means that the individuals or groups are held accountable for personal performance and achievement of targets specified by the organisation's plans.
- **Accountability:** individuals need to explain and justify any failure to fulfil their responsibilities to their superiors in the hierarchy. It is the extent to which persons are answerable for their actions, the consequences of those actions and the measured effect on results.

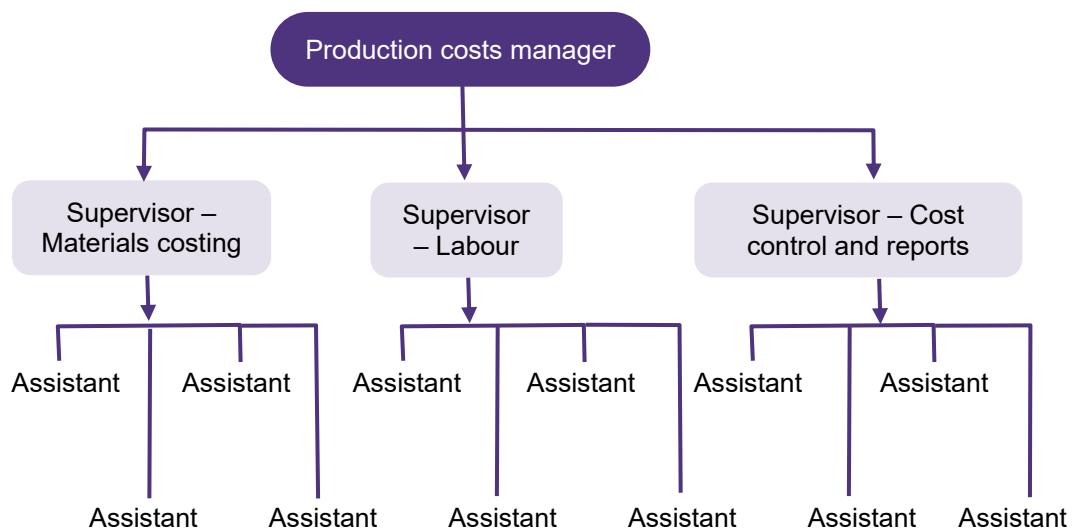


## 2.2 Sections in the accounts department

The financial accounts department may be further divided with a supervisor or manager responsible for each section e.g. sales ledger (can also be known as the receivables ledger), purchase ledger (can also be known as the payables ledger), credit control and payroll.

Management accounting work may also be divided up with accountants as supervisors of sections responsible for keeping different cost records e.g. materials, production and marketing.

Taking a section of the cost accounts department, we can outline a possible structure:



## 2.3 Location of the accounts department(s)

For organisations with different sites, the overall policy on centralisation versus decentralisation and organisational structure will have important effects on the location of the accounts departments.

In some cases the accounting function may be carried out entirely at the head office. In others each location could be responsible for all its own accounting procedures, with only interim and final financial statements being forwarded to head office.

With centralisation there is the opportunity to employ specialist accounting staff and advanced management information systems more effectively and economically.

When staff are in one central office, supervision may be improved and there is greater flexibility of staff and easier handling of peak loads. However day-to-day control over financial control systems may be lost and there may be delays in the flow of information and documents. In addition, head office staff are quite often regarded with suspicion and resentment and there may be the danger of head office becoming out of touch with the methods of working at each location.



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