

INTERNAL CONTROLS

(The case of Nyayo Bus Service Corporation, Nairobi) //

BY

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ACKNOWLEDGEMENT
DECLARATION

This Management Project Paper is my original work and has not been presented for a degree in another University.

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This Management Project Paper has been submitted for examination with my approval as University Supervisor.

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ABSTRACT

This study was aimed at documenting and evaluating the internal control system of Nyegele Tea Service Corporation, Nyegele, in an to provide recommendations towards the improvement of the existing system.

Personal interviews were primarily used as research instruments. Some investigations were also made via certain secondary data.

A historical treatment of internal control systems provided a background for the study and as the basis for evaluating the Nyegele Tea Service Corporation's existing internal control system.

DEDICATION

Fully great regards were shown to the management, purchase cycle and payroll cycle. However, some weaknesses in these cycles were also identified.

I dedicate this study to my Wife and daughter whose untiring assistance both emotional and material made my studies comfortable.

The study was conducted in Nyegele, Nyegele Tea Service Corporation. No adequate segregation of duties exist in the physical security department. It was further found that the Internal Auditor reports to the General Manager and that he performs routine control procedures.

To minimize these weaknesses and to strengthen the internal control system, some recommendations have been made, from 11. Chapter four and five.

ABSTRACT

This study was aimed at documenting and evaluating the internal control system of Nyayo Bus Service Corporation, Nairobi so as to provide recommendations towards the improvement of the existing system.

Personal interviews were primarily used as research instruments. Some investigations were also made on certain secondary data.

A theoretical framework of sound internal controls provided in chapter two was used as the basis for evaluating the Nyayo Bus Service Corporation existing internal control system.

Fairly good controls were identified in the cash cycle, purchase cycle and payroll cycle. However, some weaknesses in these cycles were also identified.

The stores area was found to be the weakest controlled area. The stores was functioning as a separate entity from the other departments of the corporation. No adequate segregation of duties exist nor are physical security controls adequate. It was further found that the Internal Auditor reports to the General Manager and that he performs routine control procedures.

To minimize these weaknesses and to strengthen the internal control system, some recommendations have been made both in Chapter four and five.

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CHAPTER ONE

INTRODUCTION

1.1 Background Information

All organisations in meeting their objectives and goals are faced with scarce and limited resources. It has thus been the responsibility of management to device, establish and supervise the implementation of internal controls via which resources will be efficiently and effectively allocated and utilised. Internal controls have been defined differently by various authors as well as institutions. However, to many accounting institutions (ICPA(K), AICPA and IASC), internal control system has been accepted as:

The whole system of controls, financial and otherwise established by the management in order to carry on the business of the entity in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the records. The individual components are known as "control" or "internal controls".¹

Two classes of internal controls namely; administrative controls and accounting controls can be identified from the foregoing description of internal control system. Administrative controls comprises of, but not limited to, the plan of organisation, procedures and records that are concerned with the decision process,

¹. ICPA(K) Kenya Auditing Guidelines - Operational No.6 Internal Controls. Nairobi.

leading to management authorization of transactions. Such authorization is the management function directly associated with the responsibility for achieving the objectives of the organisation and is the starting point of establishing accounting controls of transactions.²

The internal administrative controls have little bearing on the financial statements of a business concern. These controls are established by management to provide for operational efficiency and for adherence to corporate policies in all departments of the organisation.³

Accounting controls are those that have a direct bearing upon the reliability of the accounting and financial statements. They comprise of the plan of organisation, procedures and records that are concerned with safeguarding of assets and reliability of financial records.⁴

The size of modern business and its complexity and widespread structural organization combined with human weaknesses (Ashton and Hylas 1982) and despite the modern accounting systems and methods, a great amount of money and goods can be lost through dishonest employees, unintentional errors in the transformation and transfer of financial information used for appropriate decision making. It is in this light that internal control systems are crucial in allocating and ensuring effective utilisation of resources.

In spite of the availability of different types of controls there have been

² AICPA: **Statement of Auditing Standards** No. 1 Sec 320.27-28.

³ Meigs et al. **Principles of Auditing** 8th ED. United states of America: Richard D.Irwin Inc 1988.PP. 174-176.

⁴ Ibid

numerous incidents of fraud and errors in public and private enterprises all over the world. (Salih 1983). For instance, Hunter Jones⁵ (1979) after reviewing hundreds of companies systems both manual and computer supported, concluded that companies are vulnerable to one or another of leaking financial system.

In the Introductory chapter of his paper, 'Leaking Financial Systems' Jones gave an example of New York State which had to close down its state lottery for 11 months because a program error permitted the issuance of duplicate tickets. The lottery lost 50 million dollars in potential revenue, 325 employees were suspended and the lottery commission was disbanded as a result of the closure. In another example, Jones discussed a California man who siphoned off over one million dollars from the company where he was a Chief Administrator and Chief Accountant; a situation illustrating the absence of segregation of duties.

The United States which is always at the forefront in legislating financial matters passed the Foreign corrupt practices Act 1977. The purpose of the Act was to require U.S companies that are registered or file reports with the Securities and Exchange Commission under the Securities Act of 1934 to devise and maintain a system of internal controls sufficient to provide reasonable assurance that:

- 1) Transactions are executed in accordance with managements' general or specific authorisation;
- 2) Transactions are rendered as necessary (a) to permit presentations of financial statements in conformity with GAAP or any other criteria applicable to such statements and (b) to maintain accountability of

⁵ Jones G.H. "Leading Financial Systems- Some Horror Stories." Statement in Quotes, **Journal of Accounting**. Vol. 147. May 1979. PP. 87-90.

assets;

- 3) Access to assets is permitted only in accordance with management's general or specific authorisation;
- 4) The recorded accountability for assets is compared with the existing assets at reasonable interval and appropriate action is taken with respect to any difference.⁶

This has posed a challenge to the public companies of U.S in defining their internal accounting controls concerns in order to be in the best position to respond to a challenge as to compliance with the internal accounting provisions of the Act.

In spite of the numerous cases, carried in our dailies, of corruption, fraud and misappropriation practices both in the private and public sector of the economy, little has been done in instituting internal controls in the legislature. On the other hand, the Institute of certified Public Accountants of Kenya (ICPA(K)) has looked at the issue of internal control from the "eyes" of the external auditor. This is evidenced by the issuing of Kenya Auditing Guidelines Operational No. 1. Little effort, if any, has been made by ICPA(K) in providing guidance on the evaluation of internal controls, specifically with reference to the needs of management.

Studies carried out have focused themselves on the relationship between internal controls of firms and external auditors with particular reference to sampling procedures. (Ashton (1979), Reckers Whiltington (1982), Ashton (1982), Haskins (1987), Arnold and Weilner (1990).

In addition to assisting management in effectively carrying out its

⁶ Cook. J. Micheal, "Internal accounting control: a matter of Law". **Journal of Accountancy**, Vol 147. Jan 1979 P.56, 58, 60-64.

responsibilities, internal controls also help external auditors in reducing their audit work and subsequently their costs. "The effect on auditing has been to reduce the need for routine, mechanical verification of bookkeeping accuracy, permitting substitution of a less time - consuming approach that involves reasoning and judgment and stresses such activities as reviews, analysis evaluation and statistical sampling" ⁷

1.2 Background to the Study

Nyayo Bus Service Corporation, is a state corporation that was established in 1986 through a presidential directive. Until mid-1992, the corporation was managed as a department in the National Youth Service (NYS) under the Office of the President. It is however currently an independent state corporation managed separately from the National Youth Service.

The purpose of its establishment is:

- (i) To offer commuter services to the "Mwananchi" at rates lower than those charged by other participants in the transport industry.
- (ii) To reduce the monopoly status enjoyed by the Kenya Bus Service Ltd. over the years.

In meeting its purpose, Nyayo Bus Service Corporation offers commuter services within various cities of Kenya. These include Nairobi, where the headquarters of the corporation are situated, Mombasa, Nakuru and Kisumu.

⁷ Stettler H.F. **Auditing Principles**, Prentice-Hall, India 1980 P.54

As a result of its prior status, as a department under NYS, Nyayo Bus Service Corporation was required to adhere to government financial regulations and procedures as provided for in the Constitution of Kenya under sections 48, 99 to 105, the Exchequer and Audit Act (Cap 412) and the Paymaster - General's Act and Regulations (Cap 413). In 1992 the Kenya Parliament passed the Nyayo Bus Corporation Act. Since then, there has been a gradual shift from Government Accounting System to the conventional commercial accounting system.

In spite of the continuous effort by the Nyayo Bus Service Corporations' management in moving towards the conventional commercial accounting system, the corporations' accounting system until now is predominantly the Kenya Government accounting system. Thus, a discussion of the Kenya Government financial procedures relating to state corporations is important in facilitating the understanding of the Nyayo Bus Service Corporations accounting systems and internal accounting controls.

1.2.1 The Statutes.

The provisions regarding the management of Government finances is contained in the constitution of Kenya under sections 48, 99 to 105, the Exchequer and Audit Act (Cap 412) and the Paymaster-General Act and Regulations (Cap 413). These statutes and the Borrowing and Taxation statutes outline and define a system of administering Government finances that covers areas such as the generating and collection of revenue, appropriations, accountability and auditing.

1.3 Statement of the Problem.

Internal controls are fundamental to the success of any organisation big or small. Without sound controls the organisation will simply not attain its objectives.

In other words, they are key success factors for any organisation. They not only ensure custody of assets, eliminate unnecessary suspicion, provide assurance to management on the dependability of the accounting data used in making decisions but also assures that management direct responsibility of maintaining accounting records and producing financial statements that are adequate and reliable is being met.

State corporations in Kenya have over the years lost considerable resources through embezzlement, misappropriation and mismanagement. This is evidenced in the Auditor General and controller's annual report to the public Accounts Committee of the Kenya parliament. Such incidences of fraud and errors could partly be attributed to the lack of giving due attention to some of the trouble spots that are obstacles to the efficient utilisation of corporate resources.

The Nyayo Bus Service Corporation is a public company financed by the taxpayers funds. While the social issues of establishing Nyayo Bus Service of easing transport problems are sociologically sound, the attainment of such objectives will simply be impossible unless sound internal controls are put into place. The society at large expects that the resources of this critical parastatal are free from embezzlement and that they are efficiently utilised. The risk of loss of resources is high particularly when we take to the fact that its revenues are mainly on cash basis.

1.4 Objectives of the Study. CHAPTER TWO

The objectives of this study are two fold:

- i) To document the existing internal control system of Nyayo Bus Service Corporation, Nairobi.
- ii) To evaluate the existing internal controls and provide a framework for sound internal controls.

1.5 Importance of the study.

This study is expected to be of interest to:

- i) Management of Nyayo Bus Service Corporation, Nairobi, who are interested in the efficient and effective utilisation of the enterprise's resources.
- ii) Policy makers who may decide that the operation of a sound internal control system should become mandatory for all public companies.
- iii) Parliament to whom public corporations are accountable to and by extension the public in general that ultimately shares the benefit of a more efficient and effective utilisation of resources via a sound internal control.
- iv) Academicians and students who would increase their knowledge of internal controls and debate on the research to come up with better proposals or draw conclusions on the area of internal controls.

CHAPTER TWO

LITERATURE REVIEW

2.0 THEORETICAL FRAMEWORK

2.1 Introduction

Most information needed by management to be used in making decision about finances and the progress of operation is provided by the accountants from the accounting records. For management and other users of accounting information to derive maximum utility from the information provided, it must be reliable, relevant, complete and timely.

Accounting systems are information systems, whose function is to provide information that would facilitate the making of economic decisions. The crust of these systems is the business transactions around which the whole accounting system revolves. Closely linked to the business transactions is the problem of control.

Protection of the resources of the business is important against possible losses ranging from embezzlement to inefficient use of the business resources, unauthorized extension of credit, inefficient workers, failure to purchase from the lowest priced supplier and theft.

The size of modern business and its complexity and widespread organisational structure removes management from the scene of operations and makes personal supervision of employees by management an impossibility. Despite the installation of modern accounting systems and methods, a great amount of money and goods can be lost through dishonest employees, unintentional errors in the transformation and transfer of financial information can also occur.

As a substitute of its presence on the scene of operations, management must

rely on control techniques to implement its decisions and to regulate the activities for which management would ultimately be responsible for. It is in this light that internal control system are crucial in allocating and ensuring effective and efficient use of business resources.

The specific control features in any system depends on factors that include (i) the nature of operations, (ii) the size of the organisation and (iii) objectives of the organisation for which the system was designed. Yet certain components are necessary for a good internal control system in almost any large organisation. The ensuing section of this chapter will discuss the elements necessary to achieve good internal control.

2.2. Components of Internal Control

It is important for a system to have certain features (components) that would increase the probability that accounting information is reliable and the safeguarding of assets dependable. A good/strong internal control system would include the following:-

2.2.1. Plan of Organisation

In order to ensure that groups and individuals will work together effectively and efficiently without any duplication of efforts, organisations need to have a plan that defines and allocates responsibilities, authority and identifies lines of reporting for all aspects of the entities operations.

A lot of research has been undertaken in identifying the best structure that organisations should adopt. Findings have revealed that there is no 'clear and fast

rule'. The ideal structure of an organisation was found to be dependent on contingent variables. These variables included size, technology, environment and the strategy adopted by the organisation.⁸

The plan of organisation should provide for appropriate segregation of functional responsibilities. Such division of responsibility would provide for the efficiencies derived from specialization and possible cross-checking that would promote accuracy and reduce duplication of efforts.⁹

2.2.2. Adequate Segregation of Duties

One of the primary means of control is the separation of those duties if combined would provide opportunities for intentional manipulation.

There are four general guidelines for the segregation of duties to prevent both intentional and unintentional errors. A discussion of each follows:-

(a) Separation of the Custody of Assets from Accounting

When an individual performs both the functions, there is an excessive risk of his/her disposing off the assets for his/her own gain and adjusting the records.

Therefore as a general rule, any person performing an accounting function whether be it in an EDP or a manual system, be denied access to assets that can be misused for personal gains.

⁸ Gibson, J.L. Ivancevich, J., Donnelly, J.H. **Organisations Behaviour Structure and Process**. Dallas. Texas: Business Publications, 1976. PP. 288-314.

⁹ Ibid

b) **Separation of the Authorization of Transaction from the Custody of Related Assets.**

The authorization of transactions and the handling of related assets increases the possibility of fraud within the organisation. Hence a staff that authorises purchases and disposals of assets should not keep the title to the assets.

(c) **Separation of Duties within the Accounting Function**

Many opportunities exist as for automatic cross-checking of different employee's work in a manual system. The least desirable system is one which allows an employee to process a transaction from its original to its ultimate posting and preparation of the financial statements. This would allow for non-detection of intentional or unintentional errors and sloppy performance of duties.

(d) **Separation of Operational Responsibility from Record-Keeping Responsibility**

To ensure unbiased information, record keeping should be kept under a separate department under the Chief Accountant or Controller. If each operational department were responsible for preparing its own records or reports, there would be a tendency to bias the results to improve its reported performance.

2.2.3. **Authorization and Approval**

The system designed or in operation should make provisions for proper authorization or approval of all transactions by appropriate persons whose authorization limits are clearly specified. Authorization can be either general or

specific. General authorization means "that management establishes policies for the organisation to follow. Subordinates are instructed to implement these general authorization by approving all transactions within the limits set by the policy. Specific authorization has to do with individual transactions. Management is often reluctant to establish general policy of authorization for some transaction. It instead prefers to make authorization on a case by case basis." ¹⁰

2.2.4. Physical Controls Over Assets and Records

Physical controls are one of the most important type of protective measures for safeguarding both assets and records. They relate to custody of assets and involve procedures and security measures designed to ensure that access to assets is permitted only in accordance with managements' general or specific authorization. These controls include both direct and indirect access via documentation.

2.2.5. Adequate Documents and Records

Documents perform the function of transmitting information throughout the business concern and between business entities. The documents must be adequate to provide reasonable assurance that assets are properly controlled and transactions are all recorded. Documents and records should be:¹¹

- * prenumbered serially to facilitate control over missing documents, and as an aid in locating documents when they are needed later.

¹⁰ Lemon W.M. Alvin A.A., James K.L. **Auditing: An integrated Approach** 14thED. Scarborough, Ontario: Prentice-Hall Canada Inc. 1987 PP. 285-270.

¹¹ Ibid

- * prepared at a time when the transaction takes place or soon thereafter.
- * sufficiently simple to ensure that they are clearly understood.
- * designed for multiple uses whenever possible.
- * constructed in a manner that encourages correct preparation.

2.2.6. Arithmetical and Accounting Accuracy

These controls are concerned with checking that the transaction to be recorded and processed have been authorized, that they are all included and that they are correctly recorded and accurately processed. In other words, it entails the classification of accounts to be a base of summarization and to identify the nature of the items to be recorded, and checking of the totals to ensure arithmetical accuracy of records.

2.2.7. Quality Personnel

The human element in any system overrides the importance of the other elements in that system. The presence of competent and trustworthy employees would result in reliable financial statements even if some of the other elements were absent. Adequate personnel having capabilities commensurate with their responsibility is crucial. This requires employees with good personality, ability, qualification, experience, knowledge and training employees to enhance their abilities. These are inevitable since the proper functioning of any system depends on the competence and integrity of those operating it.

2.2.8. Internal Verification

The need for a system of independent checks arises because a system tends to deteriorate overtime unless there is a mechanism for frequent review. The basic essentials of a good system may all be present but unless internal control receives attention, "shortcut" will appear causing some procedures to be unnecessary and others inadequate. The use of an "internal auditor"; a person trained in accounting, systems and auditing is an approach adopted in maintaining and improving internal control system. Conceptually the Internal Auditor should report to the highest office in the organisation. This could be a committee of the board of directors.

Internal controls can do a lot in preventing fraud and assuring the reliability of accounting information. However, even the most elaborate internal control system is subject to certain limitations.

2.3. Limitations of Internal Control

Errors may be made in the performance of control procedures as a result of misunderstanding instructions, carelessness or other human factors. Internal controls lack the inherent ability of ensuring "efficient administration and the completeness and accuracy of the records, nor can it be proof against fraudulent collusion, especially on the part of those holding positions of authority or trusts."¹²

The Institute of Certified Public Accountants of Kenya notes.....

"Authorization controls can be abused by the person in whom the authority is vested. Management is frequently in a position to override controls which it has itself set up.

¹² ICPA(K) "Kenya Auditing Guidelines - Operations No. 6. Internal Controls Sec 2.5.

*Whilst the competence and integrity of the personnel operating the controls may be ensured by selection and training, these qualities may alter due to pressure exerted both within and without the entity. Human error due to errors of judgment on interpretation, to misunderstanding, carelessness, fatigue or distortion may undermine the effective operation of internal controls."*¹³

It is very important that these limitations are reduced to maintain a strong internal control system. An active participative board of directors and an effective internal audit department may act as deterrents to top management in overriding the internal control system.

The extent of the internal controls adopted by a business is limited by cost considerations. It is not feasible from a cost standpoint to establish a control system that provides absolute protection from fraud and waste; reasonable assurance in this regard is the best that generally can be achieved.

2.4 EMPIRICAL RESEARCHES.

2.4.1 Introduction.

The concept of internal controls has received considerable attention from researchers for a long time. Research in this area can be traced way back to Cook (1968) and Kaplan (1968) and maybe further back in time. They have tended to focus on aspects of controls that relate to performance reporting, organisation structure, behaviour and the external auditors' work. [Bruns and Waterhouse (1975), Hayes

¹³ Ibid

(1977), Piper (1980), Cook (1968), Dew and Gee (1972), Flambelz (1976), Amey (1979), Haylas and Ashton (1982), Haskins (1987) and Schneider and Wilner (1990)]. The techniques used in these studies varied from research to research. However, the common ones employed included surveys using questionnaires and statistical techniques such as correlation, regression and factor analysis.

2.5 Performance Reporting and Controls.

Research in this area attempted to look at the effectiveness of the frequency of performance reporting and control. Cook (1968) studied the effectiveness of control reports with the objective of ranking on scale the attitudes of 134 managers in 59 U.S.A companies towards the control report they received.

Cook's findings obtained via mail questionnaires revealed that the attitude of managers towards control reports was a function of the frequency with which the reports were provided. The participating managers gave the highest ratings to daily control reports and gave the lowest ratings to annual reports.¹⁴

In a related study conducted by Dew and Gee (1972) in the U.K, it was observed that the managers attached greater importance to items of control information which were provided frequently than to those that were provided rarely.

Dew and Gee (1975)¹⁵ conducted 65 interviews with providers of control reports and 64 interviews with recipients of such information with the objective of measuring the extent to which managers referred to these reports for control

¹⁴ Cook. D.N. "The impact on Managers of Frequency of Feedback". **Journal of Academy of Management**, Vol. XI. No. 3 September, 1968.PP. 273-290.

¹⁵ Dee R.B. nad Gee K.P. "The Frequency of performance reporting and Managers Reference for Control - a note, "**Accounting and Business Research**, Summer 1972 PP. 234-236.

purposes.

By comparing the relationships between the use of an item of control and the frequency with which such an item was provided and the relationship between the reasons given for the non-use of an item of control and the frequency with which such an item was provided, it was concluded that the more the item was provided the more extensively it was used.

The results of these two studies undertaken in different settings suggest that the important factor in determining as to whether managers will or will not make use of control reports is the frequency with which such reports are provided and the degree of control a manager has on the item of control.

2.6 Organisational Structure and Controls.

Studies conducted on the relationship between organisational structure and controls have come up with more or less similar findings. Ouchi (1977) using multiple regression analysis on multiple variables studied 78 retail department store companies. These variables included returns, attendance, sales volume, punctuality etc. based on measures of output. Ouchi, based on his findings, concluded that the actual mechanism of control is more complex than originally assumed.

In a related study involving multiple retailers, Piper (1980) found that the task complexity, financial control system structure and organisational structure measured on the dimensions of centralisation and decentralisation are related to each other.

Piper had generated a hypothesis that the primary determinant of the financial control system is task complexity, but its effect is via an intervening variable - the organisation structure. By conducting a case study on four companies which were

evaluated on the basis of number of stores, range of products, product characteristic, number of years in existence, store controls, manager evaluation, company financial performance, etc. he concluded that high task complexity is linked to a low level of financial control system structure and a decentralized structure while low task complexity is linked to a high level of financial control system structure and a centralized structure.¹⁶

Complexity refers to the degree of differentiation that exists within an organisation while centralization and decentralisation exists on a continuum. They relate to the degree to which central authority to make decisions is distributed among several levels.¹⁷

Bruns and Waterhouse (1975) in their attempt to understand the influence budgets have on behaviour and their relationship with other elements, conducted a survey of 25 companies. They used detailed questionnaires and cardinal rankings aimed at exploring the interaction that exists between an organisation structure and budget.

Based on their findings, they argued that budget related behaviour was dependent on centralisation, structuring and autonomy. However, they further argued that the relationships were complex.¹⁸

From the above discussion, it has been observed that a relationship does exist between organisation structure and the organisation control.

¹⁶ Piper J.A. "Determinants of Financial Control Systems, for Multiple, Retailers -some case study evidence". **Managerial Finance**, Vol. 6. No. 1. 1980. PP. 53-63.

¹⁷ Perrow C. "A Framework for comparative analysis of Organisation." **American Sociological Review**. April 1967 PP.194.

¹⁸ Burns W.J. and Waterhouse J.H. "Budetary control and Organisation structure." **Journal of Accounting Research** Vol. 13 No. 2. Autumn 1975, PP. 177-202.

2.7 Technology, Environment and Controls

Research has provided empirical evidence that technology and environment does have some influence on organisational structure. [Woodwood (1965), Perrow (1967), Mahoney and Frost (1974), Thomas (1967) and Duncan (1972)]. Further research has been conducted in investigating the influence of technology and environment on organizational control.

Khandwalla (1972)¹⁹ carried out a research on the relationship between the degree of competition and control. He concluded that the greater the degree of competition, the greater would be the need to control costs and evaluate whether actual performance met expected performance. He surveyed 92 companies using cardinal rankings and divided the variables into four independent variables; price competition, marketing competition, product quality and variety competition. The independent variable was usage of controls. His findings indicated that product competition had the highest correlation with control usage.

Hayes (1977) in a related study, conducted a survey of 103 companies, in which 274 questionnaires were used. Based on factor analysis of over 160 variables followed by path analysis, Hayes concluded that controllability and responsibility are different across department.²⁰ Therefore the above discussed studies do indicate that both technology and environment affect the organisational structure and organisational control.

¹⁹ Khandwalla. P.M. "The Effects of Different Types of Competition in the use of Management" **the Journal of Accounting Research**, Vol. 10 No.2 1972. PP. 275-289.

²⁰ Hayes D.C. "The Contingency Theory of Managerial Accounting," **The Accounting Review**, January, 1977 PP. 23-39.

2.8 The Auditor and Controls

Haylas and Ashton (1982) on their efforts to provide evidence on the effectiveness of particular audit techniques in detecting errors that affect the financial statements and on the causes of such errors, conducted a study of 281 errors requiring financial statements adjustment.

The results of the study suggested that all of the intentional errors are concentrated in relatively few audit areas and that these areas are fairly predictable by industry. The great majority of such errors affect income but the direction of effect may either be an understatement or over statement. Regarding the signaling of an error, they found that a large portion of financial statement errors are initially signalled by less rigorous audit procedures such as analytical review and discussions with the client. Client personal problems such as inexperience, incompetence and insufficient knowledge and inadequate control, follow up or review were found instrumental in causing most errors²¹

In an attempt to define a client's control environment from auditor's perception, Haskins (1987) identified 48 client control attributes and their perceived levels of importance in adequately describing a client's control environment, thus serving to define more clearly audit planning concepts. In addition, client contextual variables were found not to be frequently associated with the attributes importance ratings (except size and management structure) thus highlighting the generalisability across a variety of clients. Audit firm, firms specialization and audit rank were found to be significant mediating contextual variables and that

²¹ Haylas And Ashton, "Audit Detection of Financial Statements Errors". **The Accounting Review**, October 1982 PP. 751-765.

seniors had the largest share of the evaluation of internal control attributes responsibility.²²

In another study that examined the effectiveness of internal audit and external audit in deterring financial reporting irregularities, Schneider and Wilners (1990) conducted an experimental study that examined the effect of managers' perception of internal and external auditing on the potential of financial irregularities.

A total of 264 subjects, the majority of whom were experienced managers were required to make decisions on three cases involving materiality type of irregularity, perceived extent of GAAP violation and incentives for mistating income. The decisions were made in a situation where there was no auditing at all, only internal auditing or external auditing.

The results clearly supported internal and external auditing as deterrents to financial reporting irregularities when all of the four factors were present. It was also found that internal auditing effects were similar to those of external auditing. The study, however, suffered from the inability to explain why the existence of audits were perceived as having a deterrent effect.²³

In a similar study, Barefield (1975) found that the frequency of audits did produce significant effects on the quality of adherence to internal control procedures.²⁴

The need for an internal control system, as stated earlier, is not questionable.

²² Haskins M.E. "Client Control Environment: An Examination of Auditors Perception". **The Accounting Review**. July 1987. PP.542-563.

²³ Schneider and Wilner, "A Test of Audit Deterrent to Financial Reporting Irregularities Using the Randomised Response Technique. **The Accounting Review**, July 1990 PP. 668-681.

²⁴ Barefield R.M. "The Impact of Audit Frequency on the Quality of Internal Control". Sarasota, FL: **American Accounting Association** 1975.

Salih (1983)²⁵ evaluated the internal controls of Ethiopian Airlines, Nairobi branch and concluded that the lack of segregation of accounting and custodian functions was the greatest weakness of the branch office. He argued that there is need to centralize cash receipts, establish an audit unit, separate accounting unit from sales section, separate duties of purchase activities and establish a perpetual inventory system for the tickets. He further emphasized that the existence of controls is very crucial, especially under today's conditions with severe competition which place premium on reliable customer services, on conservation of cash, on realization of capital assets and manpower, and on the reduction of cost.

Both accountants and non-accountants appreciate the wider concepts of internal control and their contribution towards the safeguarding of assets and ensuring the reliability of financial records of an enterprise. This is confirmed by Kaplan's findings that there exists no significant difference between the actual behavioral mode of management accountants and the actual behavioral model held by non-accountants. Half of the interviewed accountants and managers indicated that accounting control was necessary because employees tend to be deliberately lazy and wasteful or at least indifferent to any cost-saving effect. The other half also believed that accounting controls were necessary in reducing costs even if managers co-operated.

²⁵ Salih M.A. "Internal Controls : The Case of Ethiopian Airlines, Nairobi. M.B.A. Management Project. 1983.

CHAPTER THREE

BACKGROUND TO NYAYO BUS SERVICE CORPORATION ACCOUNTING SYSTEM

3.0 INTRODUCTION.

Government accounting distinguishes itself from commercial accounting in that Government accounting concerns itself only, with receipts and expenditure occurring within the Government's financial year. It is entirely cash based, and apart from the relaxation of the time limits in specific instances, the government accounts of a particular financial year consist solely of the cash transactions occurring within that financial year.

3.1 The Government Accounting Systems.

The Government's financial system entails appropriation of funds by parliament to ministries and departments as arranged according to votes. An accounting officer is appointed to be responsible for each vote and is personally liable for the aggregate accountability and is answerable for the same to the parliament. An Accounting officer:

Means a person appointed to be an accounting officer within the meaning and for the purpose of the Exchequer and Audit Act (Cap 412) which defines the accounting officer as:

Any person appointed by the Treasury and charged with the duty of accounting for any service in respect of which money have been appropriated by parliament or any

person to whom issues are made from the exchequer account."²⁶

The book-keeping and accounting systems adopted by Government ministries and departments are standardized and is entirely cash based. The Government accounting system concerns itself with receipts and expenditure occurring within the Governments financial years (1st July to 30th June). However, Government trading organisations such as corporations use the conventional commercial accounting system, involving non-cash adjustments, such as accruals, prepayment, depreciation etc. In spite of this relaxation, corporations under ministries adopt the conventional commercial accounting system at a very low scale, as is the case with Nyayo Bus Service Corporation.

3.2 Vote Procedures.

No funds can be spent or committed by any officer of the government until he has been properly authorized to do so by means of an Authority to incur Expenditure (A.I.E). Each accounting officer is expected to maintain records (vote book) that will clearly show at any time, in respect of each vote:

- (i) the total amount of expenditure sanctioned for the year.
- (ii) the amount of the expenditure charged.
- (iii) any further known liabilities in respect of the year.

Similarly, the officer receiving the A.I.E must also open a vote book to control the funds allocated to him and show clearly at any time:

²⁶ The International and General Provisions Act (Cap 2), part 2 Section 3(1) Revised Edition 1983 (1970).

(i) the actual expenditure;

(ii) the total commitments, and

(iii) the actual uncommitted balance.

He/She should also note that he cannot delegate his/her responsibility. Only those officers to whom the A.I.E is issued are permitted to commit any funds or incur expenditure against it.

3.2.1 Maintenance of Vote Book

After the opening of the votebook, the A.I.E holder must ensure that:

- (a) Every payment voucher processed is entered in the votebook.
- (b) After each voucher entry the actual total payment figure is amended.
- (c) Every commitment is entered - realistic approximate values may be obtained from suppliers, stores catalogue e.t.c.
- (d) After the entry of the commitment the total commitment figure of total commitment plus total payment is obtained from which the balance available is computed.
- (e) When a commitment becomes an actual transaction it is deleted and the total commitments and the total payments figures are adjusted accordingly.
- (f) Every voucher originated by him has a serial number allocated by him. This will comprise four digits commencing at 0001 and will be that vouchers' identity.

3.2.2 Voucher Processing.

The movement of vouchers through various sections in the course of being processed is controlled via registers which are signed by the receiving sections. Although no limit as to the number of registers to be maintained for processing vouchers has been specified, a minimum of three registers must be in use to record movement of vouchers as follows:-

- (1) one from voucher preparation section,
- (2) one from voucher examination section,
- (3) one from vote book control section.

3.2.2.1 Voucher Preparation.

Payments are to be processed immediately in respect of demands for settlement of goods and services which have been supplied or rendered to the Government in accordance with valid regulations, scales, tariffs, contracts or agreements and which have been supported by L.P.Os, L.S.Os, invoices, receipts, receipted bills duly confirmed by the receiving officers or A.I.E holders.

The payment vouchers are to be prepared in at least triplicate copies for distribution as follows.

- (a) the original is to be retained to support the cash book entry and for posting of the appropriate ministry departments ledger account;
- (b) the duplicate is to accompany remittance to the supplier/payee as the case may be, and
- (c) the triplicate is for the A.I.E holder.

In a case where more than one account is involved additional copies are to be prepared for each account number and/or station for A.I.E holder. The vouchers prepared are to be authorized by the A.I.E holders who signs the original only and passes them for examination purposes.

3.2.2.2 Voucher Examination.

The signed vouchers are to be scrutinised by the examination section to ascertain that:-

- (a) the expenditure is in conformity with the authority governing the payment:
- (b) there exists an allocation to cover that expenditure and that the allocation has not and will not be exceeded as a result of the payment.
- (c) the payment is supported by appropriate certificates.
- (d) the payment voucher is complete in all aspects and all payment procedures have been complied with.
- (e) the payment voucher is authorized for payment by the A.I.E holders or an authorized official.

After examination, the examination officer or section head will complete the appropriate certificate to indicate that the vouchers have been examined and passed for payment and therefore pass them to vote book control section.

3.2.2.3 Vote Book Control.

At receipt of the examined voucher, the officer incharge of Vote Book Control Section will enter the payment in the vote book and complete the appropriate

section to indicate that expenditure has been entered in the vote book and also show the balance of funds remaining after each payment.

The officer incharge shall ensure that an allocation exists to meet the expenditure and that the allocation has not and will not be exceeded as a result of the payment.

The then entered payment vouchers shall be passed to the cash office for payment.

As payment is effected, the payment vouchers are to be sent to the ledger section for keying into the account ledgers and at the end of every month a trial balance and extracts of computer statements of every ledger account is to be produced. The accounts branch will send the extracts of the computer statements of accounts to the A.I.E holder to reconcile the statement with his vote book and to submit accounts branch a certificate of reconciliation, together with a net of outstanding or incorrect enteries.

3.3 Stores Accounting.

Deciding upon the measures to be adopted to secure adequate stock control and accounting procedures covering the receipt, custody, issue and disposal of stores etc. is the responsibility of the accounting officer. The accounting officer is responsible for stores and other Government property acquired by his ministry or department and for any losses arising. In deciding on the extent of verification the accounting officer is expected to undertake a cost benefit analysis of detailed investigation of discrepancies.

The stores accounts are to comprise of stock ledger accounts which are posted

from properly authorized vouchers to show quantities received, quantities issued or otherwise disposed off and current balances. The accounts are to be maintained by officers, other than storekeepers, who should not be allowed to have access to the stores.

3.3.1 Receipt of Inventories(stores).

Receipt of all stores are to be entered in record immediately, preferably at the point of receipt. At delivery of ordered stores, an appropriate officer is expected to certify that deliveries do meet the specifications provided. As a matter of control the ordering of stores, verification of deliveries and authorization of payment is allocated to different officers. Neither is payment to be made before the identifying with and checking of the order against the receipt document and invoice.

3.3.2 Issue of Stores.

Requisition orders are to be made and signed by officers authorized to do so by the accounting officer and that storekeepers should issue stores only against orders approved by the authorized officers.

Issue vouchers subsequently prepared and registered in the stores office, should show the service for which the stores was acquired, indicate authority for issue and bear signature of the person to whom the stores are issued.

3.3.3 Stock taking.

The regulations require that;

- (a) stock taking should be carried out at least once after six months.

- (b) Two officers should undertake the stock-taking aspect, one of whom should not be known to the store keepers.
- (c) The sequence of stock taking should be varied from time to time.
- (d) The programmes for stock taking should not be known to store keepers.
- (e) Stock balances found on stock taking should be compared with the corresponding store account balances.
- (f) Discrepancy should be investigated to arrive at correct stock figures.
- (g) Any adjustment to store accounts found to be necessary to make them agree with actual stocks should be made only on the authority of an officer authorized to do so.
- (h) Deficiencies discovered on stock-taking should be treated as losses and must be noted in the appropriation account.
- (i) The results of stock taking should be retained and made available for inspection by internal audit and by officers of the Exchequer and Audit Department on request.

3.4 Accounts of state corporations

3.4.1 Introduction

The state corporations Act No. II of 1986 governs all matters pertaining to the establishment, control and regulations of state corporations. Part IV of the Act governs in particular issues relating to control of finances of corporations. The Act requires every state corporation to prepare not later than the end of February in every year, and submit to the Minister and Treasury for approval, estimates of corporations revenue and expenditure for the following financial year. The estimates

must be accompanied by proposals for funding all projects to be undertaken by the state corporation, or the implementation of which will continue during the financial years to which these estimates relate.

The Act further stipulates that no annual estimates and proposal for funding can be implemented until they are approved by the Minister assigned the ministerial responsibility for the corporation concerned with the concurrence of the Treasury, incur any expenditure for which provision has not been made in the approved annual estimate.

Accountability for the moneys, the financial business and the management of the affairs of the state corporation befalls a board that is constituted in accordance with sections 6(1) of the Act. The Chief executive of the state corporation represents the board in answering questions that may arise from the report submitted to Public Investment Committee under section 30 A (b) of the Exchequer and Audit Act.

3.4.2 Accounting System

The accounting system to be used, according to the Act, is to be a full commercial accounting system which incorporates non-cash adjustments such as reserves, provisions, accruals and prepayments with accounts for capital, liabilities and assets. The preparation and presentation of the accounts are to generally conform with the requirements of the standard set by the Institutes of certified Public Accountants of Kenya. It is also expected that some form of costing and management accounting will be employed to assist management to run the enterprise on sound commercial basis.

The financial years of every state corporation shall be the period of twelve months ending 30th June in each year.

RESEARCH DESIGN AND EMPIRICAL ANALYSIS**4.0 INTRODUCTION**

This chapter details out the research design used to achieve the objectives stated out earlier in the study. It documents and evaluates the existing Internal Control system of Nyayo Bus Service Corporation paying due attention to the cash receipts cycles, cash disbursements cycle, purchase cycle, payroll and stores accounting cycle.

4.1 Research Design**4.1.1 Data Base**

This study made use of primary data obtained via personal interviews with selected staff and management groups. The personal interviews were conducted on the basis of interview guidelines developed for each distinct area.

(See Appendix 3 - 6).

Prior to the designing of the interview guidelines, discussions were held with the Executive chairman and General Manager coupled with visits to the Head-office with the purpose of acquiring a thorough understanding of the entity's transactions and the likely areas of weaknesses in the corporate's controls.

Observations was also made of:

- i) The system of cash receipts by the conductors from the passengers and from the conductors to the cashier.
- ii) A series of forms, documents and records that are used by the corporation in its accounting system.

- iii) The incomplete procedural manual drawn up by the Chief Accountant.
- iv) The proposed organisational chart of the organisation.
(See Appendix 1-2)
- v) Copies of Nyayo Bus Corporation Final Accounts from 1988- 91 at the Office of the President, Kenya.

The questions posed to the interviewee, as can be seen in Appendices 3 - 5, were open-ended questions. This was aimed at encouraging the interviewee to provide as much information as possible. Personnel interviewed included sub-cashiers or revenue cashiers, the Main Cashier, the Reconciliation Officer, the Machine clerks, the Vote Book Officer, the Purchasing Officer, the Payroll Officer, the Stores Officer and the Chief Accountant.

The interviews, were aimed at obtaining information as to the existing internal controls of each section and also encourage the different levels of staff to 'air' their views and opinions about the existing system. The interviewees were also asked to provide recommendations as to how the existing system could be improved so as to institute stricter internal controls.

4.1.2 Empirical /Data Analysis

The primary data collected via the personal interviews with various levels of the corporation's staff and inspection of the records of the corporation were evaluated through the use of Internal Controls Questionnaires ICQs (See Appendix 6-12) for each section studied.

The sections which were evaluated included the cash cycle, the purchase cycle, the payroll cycle and the stores accounting system.

The ICQs have been developed on the basis of theoretically sound and generally accepted accounting controls. This is aimed at facilitating the identification of weaknesses in the existing internal control systems and the suggestion of workable recommendations to improve the existing system using the components of sound internal control systems discussed in chapter two as a 'benchmark'.

4.2 Empirical Analysis

The following subsection will analyse the proposed organisational structure and then proceed to document and analyse the existing internal control systems section after section with the aim of forming 'ground' for the conclusions and recommendations to follow in the next chapter.

4.2.1 Plan of Organisation

From the discussions with the General Manager and other members of the corporation's staff, it was revealed that duties, responsibilities and authority of management was largely governed by the relevant statutes that regulate the Government financial policies and procedures.

The organisational chart in Appendix 1 and 2 is a proposal from top management to the board of directors seeking approval for its implementation. It is the managements belief that with the implementation of the proposed organisation chart, the organisational structure shall be more clear and elaborate to suit the corporations commercial nature.

The current structure in operation is in line with the proposed organisational chart with the exception of the existence of a financial accountant, a management

accountant, research and development officer and a well defined and structured personnel department. This state was partly attributed to the corporation being in a transition period; the corporation is moving from its previous status of being a department under the National Youth Service of Kenya housed in the Office of the President to the status of a full state corporation.

A review of the "manual of organisation" was not possible since management was still working on defining the principles and concepts underlying the corporations accepted methods of operations and on the specification of position description of each member of staff.

Analysis of the proposed organisational chart reveals that there is need to have a more detailed organisational chart that would take into account the sub-units and positions that exist within the jurisdiction of each officer. For example, the offices of Chief Accountant, or purchasing department/officer and inventory control of stores e.t.c are not clearly designated in the organization structure or chart. This is an anomaly to be addressed to as a means of insuring sound internal control.

It was also observed that the internal auditor, both in the current system as well as in the proposed system is and would be reporting to the General Manager. Assuming the General Manager has full executive powers, this may be okay. However controls will be enhanced if he is to report to the Board of Directors directly.

In examining the task performed by the internal auditor, it came to light that, his task was predominantly the confirmation and verification of the payment vouchers and the supporting documents. This task is seen as a routine control procedure similar to the one performed by the Examination section thus it is not a task to be

performed by an internal auditor.

4.2.2 The Cash Cycle

The nature of transactions of Nyayo Bus Service Corporation dictates that more than 98% of its revenues are on a cash basis. Secondly, having had its origin as a department in National Youth Service, the government accounting procedures still dominate in its accounting systems. As a result, Nyayo Bus Service Corporation maintains not any accounts receivable ledgers nor accounts payable ledgers. Revenue is accounted for when cash is received from the private hires and from the conductors. While expenses and purchase of suppliers is recognised when cash is paid. No liability or receivable accounts are set up.

In documenting the cash receipts system one would identify that its origin is in the Kenya Government system despite the modifications that have been made. The cash payment or disbursement is purely the Kenya Government cash disbursement system.

4.2.2.1 The Revenue Collection Procedure (Cash Sales)

According to the information gathered through the interviews and inspection of the procedural manuals, it is the responsibility of RECONCILIATION OFFICE to store and issue ticketing machines together with the Waybills²⁷. It is also the policy of the corporation that any vehicle leaving the premises for the purpose of trade is to be issued with a Waybill and a ticketing machine. The reconciliation

* A waybill is a document used to capture information about the conductor to whom the machine is issued, the details of the machine counters, the serial number of machine etc. It's purpose is to provide information that can be used to calculate the collections made by a conductor on his shift

office is also responsible for the production of the Waybill forms and the monitoring of the same.

Before issuing the Waybill to the clerk responsible the forms are numbered serially by use of a numbering machine by a clerk responsible for the same. The Waybills are then signed by an officer assigned this duty at the computer section. The Waybills are then handed to the clerk responsible for the issue of machines by use of a dispatch book. When issuing ticketing machines to conductors the clerks inserts the figures appearing on the machine counters on the respective spaces provided on the Waybill form. The ticketing machines have a seal that makes manipulation of the machines difficult unless the seal is broken. The machine counters facilitate the calculations of each conductors collections.

An allocation form designed at the reconciliation office is also used to issue machines, accompanied by Waybill forms, and to monitor the movement of the machines. The form is designed such that a conductor collecting a ticketing machine has his name, personnel number and the serial no. of the machine issued to him. The conductor and the clerk issuing both sign on the form. The machine allocation form classifies the ticketing machines according to their make and contains captions for machines under repair at the workshop, machines received from the workshop, machines not issued and machines not received. This allocation form monitors the day to day movements of the ticketing machines.

When issued with the machine and waybill, the conductor is required to verify the figures written on the waybill by the issuing clerk to be correct. He is then required to bring down this figure on the specified spaces below the figures written by the clerk. At the gate before the vehicle leaves the premises of the

corporation the machine no. and the conductors no. are recorded.

4.2.2.2 Cash receipts

After completion of duty, the conductors pay in all revenues to the receiving cashiers. The cashiers work in 2 shifts and each cashier has a cash box.

Cashiers confirm the amount received from the conductors through counting and issues a receipt to the conductor for money received. The official receipts are normally in triplicate (revenue cashier: official receipts). The conductor attaches the original receipt to the waybill and takes it to the machine and waybill reconciliation office. The revenue cashier: official receipts are normally serially numbered. The duplicate is sent to the main cashier's office after banking the amounts and the triplicate is maintained in the sub-cashiers office.

The sub-cashiers in addition to issuing the official receipts, enter the receipt no. on the waybill. In case, some expenditure was incurred by the conductor in the course of his duty, the collecting sub-cashiers verifies the supporting documents and sign the documents. The receipts issued to the conductor by the collecting cashier would be for the total amount received from the conductor and the expenditure incurred. Authority to accept such expenditure is vested in the sub-cashier and is limited to specific items contained in the waybill e.g. Toll charges.

At the end of the days shift, the outgoing cashiers and the incoming cashiers cast the collections from the duplicate copy of the official receipt and confirm by counting the cash. The taking-over cashier then signs at the back of the last duplicate receipt the beginning serial number and the ending serial numbers of the duplicate receipts and the amount received. Out of practice, the cashiers put down the

denomination of the cash being handed over but both the duplicate receipts and the improvised denominations sheet remains with the taking-over cashiers (Night cashiers).

At the end of their shift the night cashiers total the collections and balance them with receipts, prepare the banking slips and bank the collections. The processed banking slips and the duplicate receipts are then passed to the unit cashier who prepares an F-0 17 (Receipt voucher) in duplicate for the period which tallies with the bank pay-in slips.

The receipt voucher is then entered in the duplicate cash book and is balanced at least daily. The duplicate cash book and the supporting documents are then taken to the **examination section** for continuity marking and internal audit examination. They are then passed to the **vote book section** for revenue recording in the vote book.

All the records and documents including the payment vouchers are then submitted to the main cashier for entry in the main cash book. The main cashier also signs the receipt voucher after verifying its accuracy and completeness and then sends the duplicate cash books and the duplicate revenue voucher to the unit/revenue while the original revenue voucher and duplicate revenue cashier receipts are retained temporarily in the main main cashier's office.

The unit/revenue cashier is also charged with the responsibility of preparing payment vouchers in triplicate for the specific expenditures incurred by conductors in the course of their duty. Toll payments are listed serially and the registration of the vehicles are listed too. The supporting documents are then attached to the payment vouchers and sent to the examination section, then the internal auditor

section and eventually to the Chief Accountant for approval. After approval, the payment vouchers (PV) are taken to the vote book section for entry and to be given a voucher no. The duplicate PV is retained by the voting section while the triplicate is retained by the Chief Accountant and the original is sent to the main cashier for stamping "paid" and posting in the main cash book.

These vouchers are controlled using F.O.C. 10 (Daily posting cash book summary) to indicate both opening and closing balance and the net figure for the day. The main cashier then signs for the accuracy of the net figure and the manner in which it is arrived at. All vouchers both receipt and payment vouchers are then passed to the **ledger section** for sorting and balancing whereby they are given batch numbers using control slips F.O.8 for receipts and F.O. 9 for payments.

4.2.2.3 Handing in of machines

After attaching the original copy of the revenue cashiers official receipt to the waybill, the conductor hands over to the receiving clerk at the machine issuing room the waybill together with the machine. The receiving clerk then confirms the closing figures on the machine and enters them in a specified space at the bottom of the waybill. The closing figure in the waybill together with those appearing on the ticketing machine counters are then used to prepare a new waybill which is stored together with the machine in readiness for use in the next shift.

The verified waybills are then checked by officers other than the receiving clerk to ensure that all information is contained in the waybills and to note any revenue irregularities they may come across.

4.2.2.4 Reconciliation office

The reconciliation office is responsible for the calculation of the amount of revenue collected as from the opening balances and closing balances reflected in the waybill. After calculation, the amount calculated is then compared to the amount contained in the original revenue cashier: official receipt. Where irregularities, as shortages or surplus, are identified these are documented in a revenue analysis sheet. A revenue analysis sheet is a summarization of the waybills issued per shift and it captures all the information contained in individual waybills, and indicates any short or excess in the revenue that was to be received from the conductor according to the waybill. The revenue analysis sheet is normally prepared in triplicate.

The individual waybills are then collected from machine room (reconciliation office) by an officer from the computer section for punching in with the use of a dispatch form. The computer section produces a report on the revenue collected, shortages and excess which is cross-checked against the revenue analysis sheet. Any correction required on the print out is communicated to the computer section through the head of reconciliation office.

After corrections, the original revenue analysis sheet is sent to the General Manager while the duplicate is sent to the operations manager. The revenue analysis sheet is used as a basis for;

- i) confirming the daily register's cast of the total collections for each day.
- ii) preparing letters for the recovery of shortages and questioning of excesses to the conductor.
- iii) planning and control.

A report is then written to the Chief Accountant showing the shortages and excess that have arisen.

Waybills are then received by the reconciliation office from the computer/data section via dispatch schedules produced by the computer section. These waybills are then filled in separate folders, in the reconciliation office, for each machine.

4.2.2.5 Cash Payments

(i) Cheque payments.

In the case of the purchase of goods, invoices for goods and services supplied, payment vouchers are prepared in triplicate by the vote book section after receipt of invoices, delivery note, counter receipt voucher (S.13) and the duplicate copy of the local purchase order from the stores. Payment vouchers are entered in a merchant dispatch register and taken to relevant officers for certificate (E.g stores, operations manager, workshop etc)

The payment vouchers are then serially numbered, noted in the payment voucher control register, recorded in a control sheet and forwarded to the Examination section. The examination gives the voucher a control number and then examines it accordingly. The vouchers examined are then returned to the Vote book section for vote entry.

After the payment voucher has been entered in the vote book, the vouchers are recorded in the merchant movement register and taken for authorization. Approved and authorized vouchers are then taken to the internal auditor for audit.

Vouchers are then taken to the main cashier for cheque writing. Cheques are then sent to the 3 signatories for signing accompanied with the payment vouchers and

supporting documents. Signed cheques are then issued and dispatched at the Chief Accountants office by the secretary using a cheque dispatch register. The cheques are always crossed.

The main cashiers normally enter all cheques drawn in a cheque register. The original payment vouchers and the supporting documents are sent back to the cashier to be retained temporarily and to facilitate posting in the main cash book.

The duplicate accompanies remittance to suppliers while the triplicate is retained by the A.I.E holders. All original payment vouchers are then passed to the ledger section for sorting and balancing.

(2) Petty Cash Payments.

Requests for cash payment originate outside the Chief Accountant's office. Only departmental heads are authorized to make request to the Chief Accountant for cash. The Chief Accountant or in his absence, the General Manager or the operations manager can authorize such payments. After approval, the approved request (which has no standard format) is sent to the petty cash cashier who makes payment and requires the receiver to sign the payment schedule which is prepared in duplicate.

Entry is then made in a duplicate cash book by the petty cash cashier. The duplicate payment, the approved requests and any supporting document is then sent to the vote section for voucher preparation. It is important to note that the payment vouchers are to facilitate reimbursements. The payment vouchers undergo the same process as the PV drawn for cheque payments. The only difference is that after authorization for reimbursement, they are sent back to the sub-cashier. After a

week, the petty cash cashier casts authorized reimbursement and draws a voucher for all the individual petty cash reimbursement and all supporting documents are attached and verified again. The petty cash book is verified daily and casted daily by an officer charged with that responsibility.

The verified documents are sent to the main cashier who writes up the cheque for reimbursement.

The vouchers are stamped 'paid' and the original remains temporarily with the main cashier, while the duplicate remains with the signatories to the cheque and the triplicate with the petty cash cashier. Occasionally the internal auditor undertakes spot cash checks.

4.2.2.6 Analysis of the Cash Cycle.

As observed, cash receipts as well as cash disbursements are areas that bear fairly strong controls. The strengths of the internal controls of the cash receipts are evident in the documentation procedure that occurs at the machine office both when the ticketing machines are issued and received. The machines themselves contain a seal that prevents the manipulation of the counters. However, in the course of his duties, the conductor has a good opportunity of embezzling the corporate's revenue by not ticketing the passenger. The absence of inspectors on the route is a weakness in the revenue collection system.

Proper segregation of duties exist in the cash receipt cycle. The employee entering the opening balances in the waybill as well as the closing balances has no access to the cash to be received. Neither does the revenue clerk has any responsibility in entering entries in the waybill that may provide an opportunity for

him or her to embezzle the cash by manipulating the entries. Deposits are made daily by receiving clerks except over the weekends. This policy that encourages prompt banking is in conformity with sound internal control system.

The reconciliation office tasks act as internal checks to the work performed by the revenue cashier and sub-cashiers, while the computer/data section acts as an internal check of the work performed by the reconciliation office. The reconciliation office task is crucial in that it attempts to recover shortages from conductors thus safeguarding the revenues that belong to the corporation.

The existence of the Examination section and the internal auditor enhances the strength of the system. However as mentioned earlier, it appears the task of the internal auditor is not clearly defined. He engages in a task that has already been performed by the examination section. It is not befitting for an internal auditor to engage in routine controls.

Despite the soundness of some of the installed procedures, some weaknesses were noted in the whole cash cycle. The reconciliation office is charged with the responsibility of producing the waybills and maintaining stock of the same. This should not be the case since it depicts a situation of a department producing the same document, engage in processing the document and ultimately storing the processed documents. This would provide a loophole for the manipulation of the waybills themselves. It was also noted that apart from entering the waybill no. in the machine allocation sheet, no other document or record are used to enter the entries that exist in the waybill. A conductor may lose a waybill either accidentally or intentionally and it would consume more effort to try and trace the previous shift waybill while being processed.

From observing the system of issuing ticketing machines, it was gathered that very little control is observed as to the usage of the waybills. Waybills (blank) were scattered all over the tables and others were torn off the booklets to be used for other purposes other than their rightful purpose. This reflects that management does not follow up the sequential numbers of the waybills and neither does it query for any break in the sequence of the filled waybills. If the opposite was so, then the waybills would be handled with a lot of care.

In spite of the provisions made in the machine allocation sheet that requires conductors to sign when receiving machines from the issuing clerk, no provision has been made for the conductors to sign that they have returned the machine. This provides an opportunity for the receiving clerk to claim that a machine was not issued back, yet the conductor did so. One may argue that, this is taken care of when the receiving clerk enters the machine closing numbers in the waybill. This procedure, however, is an implication that the machine was received by the receiving clerk. A signature of the conductor would have more weight than this implication. It was also noted that, receiving clerks did not check as to whether the seal in the machine is broken both when issuing the machines and when receiving them.

Regarding the revenue cashiers, deficiencies are evident in the handing over process. Handing over cashiers and taking over cashiers merely write the serial number of the beginning receipt numbers and the last receipt. Individual amounts of each receipt is made neither in any document used that could confirm the handing over of cash from one cashier to another when changing shifts. With the current system, the handing over cashier has no way of proving that he did hand over a

certain sum of money since all documents signed are left in the custody of the taking over cashier. The unit cashier that prepares a receipt voucher is also charged with the responsibility of preparing payment voucher for expenditures incurred by the conductors in the course of their duty. This should not be the case since it provides an opportunity to manipulate the net figure balances.

Generally, the controls relating to the cash cycle are fairly sound. However management, needs to tighten up loopholes identified to improve the system.

4.2.2.7 The Payroll System.

According to the interviews conducted, the payroll department is a recently established department with only one payroll officer who was transferred from the internal audit department.

Discussions with the Chief Accountant and the newly appointed officer revealed that letters authorizing the placing of a name on payroll originate from the personnel department. Any amendments to the payroll can either be authorized by the personnel department head, the General Manager or the Chief Accountant. The payroll officer normally receives the payroll print from the computer section. She sends it back to the computer section for processing with any document that may act as supporting evidence for any amendments to be made to the payroll.

Once the adjusted payroll is printed out, it is sent back to the payroll officer who prepares a payment voucher. This payment voucher and the print out with all the supporting documents undergoes the same process as any other payment voucher.

The authority for payment is given by the Chief Accountant. The original payment voucher is then sent to the cashier while payslips are printed out by the

computer section. The cashier prepares the pay packets and payment is made by a sub-cashier who requires the recipient to sign a pay-sheet.

Payment of salaries is made in cash thus requiring the cashier to make the necessary postings to the cash book. Any uncollected pay-packets are handed back to the main-cashier who locks them up in a safe and sends a report to the payroll for the initiation of investigations.

A program in the computer section is used to prepare the payroll with all the deductions.

a). **Strengths of Payroll Procedures.**

The payroll system is another area that bears both strengths and weaknesses. The strengths of the system can be judged from the existence of the examination section, the internal audit, the cashier office and the payroll office. Adequate segregation of duties does exist thus making it possible for the work of an individual or office to be checked by another individual or office.

b). **Weakness of Payroll Procedures**

However, a number of weaknesses also do exist in the payroll system. No system or procedure exists that would facilitate the cross-checking of the print-out given by the computer section initially. The payroll officer merely indicates on the print-out the adjustments to be made to the payroll and attaches the supporting evidence before she sends the print-out back. This implies that the wage rates are not checked regularly against personnel records. Thus making it possible for the computer department to easily adjust the wage rates without the knowledge of any of

the other sections.

The paying of salaries using cash is another weakness in the payroll system. The use of cash makes it easy for either the sub-cashier or the main-cashier to misappropriate the uncollected paypackets and it would also make it difficult for one to discover such an irregularity.

4.2.2.8 The purchase cycle

Interviews with both the purchasing officer and the stores officer revealed that the purchasing activity is set off by a requisition request that emanates from the stores officer. The user department normally makes a requisition order to the stores through the use of a Counter Requisition and Issue voucher which is normally written and signed in triplicate. These requisition and issue vouchers are normally serially numbered. In turn, the stores officer would raise another Counter Requisition and Issue Voucher and send it to the purchasing department after signing it.

The purchasing officer then invites quotations by pinning up a notice on the tender invitation board. The tenders are received through the tender box located within the premises and are collected by the purchasing officer who has the key to the tender box. The tenders are normally brought in sealed envelopes.

At the tender board meeting the envelopes are opened and each member present signs on the received quotations to confirm that they have seen the quotations. The relevant details contained in the quotations are then entered in an adjudication form and a price comparison schedule is also improvised on the adjudication form. A decision is then reached by the tender board as to which tender

to accept after consultation with the relevant user department which is also represented on the board. The members of the board are again required to sign on the adjudication form to confirm the decision they have reached.

The adjudication forms are normally filled in four copies. The first copy is retained by the purchasing officer to act as an authority to write up the purchase order. The second copy is sent to the vote-book section to act as the basis for preparing the payment vouchers. The third copy and the fourth are sent to the internal auditor and stores respectively.

The purchasing officer then, after approval of the tender board, prepares the Local Purchase order in four copies. The original and duplicate are sent to the suppliers who return the duplicate signed and stamped when delivering goods. The triplicate is sent to the vote section attached with the adjudication form, while the fourth copy remains with the purchasing office.

When delivery is made, the invoices with the duplicate local purchase order and a copy of the delivery note from the suppliers signed by the stores head are received by the store officer who sends the received documents to the vote book section for the preparation of the payment vouchers. In the case of emergencies, the purchasing officer raises a request for cash which is approved by the Chief Accountant. In the case of suppliers who have monopolies, invitations to tender are not made. The cost of the supplies is acquired from the price list supplied by such suppliers and the tender board's approval is minuted to act as authority to purchase. At times, the suppliers are requested to send a proforma invoice before the board approves of the purchase.

4.2.2.9 Analysis

As observed, this is another area that bears both strengths and weaknesses. The strength is evident in the policy that local purchase orders can only be raised by the purchasing officer after the approval of the board. The system also provides a mechanism that makes it possible for the vote book section that prepares the payment vouchers to ascertain as to whether proper authority was received or not. Again, the duties of the purchasing officer are limited such that he has no role to play in the preparation of payment to the suppliers.

However, in spite of these strong controls instituted in the purchase cycle, serious deficiencies exist in the system. Discussions with the purchasing officer revealed that the purchasing office does at times pick up supplies from the suppliers. As a buyer, the corporation should not pick the goods from the suppliers. This is to safeguard the corporation's interest in assuming liability before the supplies reach the corporation's premises. It also makes it difficult to verify that goods have actually been received.

Access to the tender box being restricted to one individual is another weakness in ensuring that all tenders received are going to be tabled in the tender-board meeting.

In the case of emergencies, the providing of authority to the purchasing officer to raise a request for cash to meet such emergencies is another serious defect in the system. Management should contract agents who shall be responsible for handling such emergencies. These agents can then bill the corporation for services rendered to it.

This prior contracting of suppliers would cover the loophole that could be

exploited by its purchasing officer for his own personnel interest as opposed to the corporations interest.

The use of a counter requisition and issuing voucher for both requisitions and issues poses a problem in that the same document is used for conflicting activities. Control of such vouchers becomes a problem and their effectiveness is impaired due to the inability to control them.

4.2.2.10 The stores

a) The issues of supplies

Request for supplies are raised by user department through a Counter Requisition and Issuing Voucher filled in triplicate. The Counter Requisition and Issuing voucher are issued to all user departments and they are pre-numbered serially. The user department on a regular basis furnish the stores with a list of names of personnel who are authorized to make requisition request to the stores. Specimen signatures accompany the list.

Once the requisition voucher is received by the stores clerk, items are picked and brought to the counter. Both the stores clerk and the user department agent verify the material. The agent is then required to sign on the original Counter Requisition voucher that he has received the supplies. A gate pass is then raised in duplicate and is signed by the stores officer or his assistant. The agent attaches the gate pass to the duplicate Counter requisition and Issuing Voucher (CRIV) and takes the material to the user department.

The original CRIV is then entered in a register and the necessary entries are made on the bin-cards.

b) **Receipts of Supplies**

When goods are delivered by suppliers to the stores, the stores raise a counter receipt voucher in duplicate to acknowledge receipt. The original is sent to the vote-book section, accompanied with the invoices, the delivery notes for the processing and duplicate LPO received from supplier for payments. The copy is maintained in the files of the stores. The receipts are then recorded on the bin-cards. The documents are sent to the vote book section via a register maintained to monitor the movement of documents from the stores to the vote book section. In receiving goods, user departments are asked to verify and certify on the counter receipt voucher that the goods delivered are what was requested.

4.2.2.11 **Analysis**

The stores issuing, receipt and accounting systems are characterized by very serious deficiencies that render the internal control system for supplies very weak. No system exists that requires the flow of information from the stores to the accounting section and vice versa that would allow the accounting section to control the stores through the use of stores control account.

Again the problem posed by using one document ie CRIV for both requisitions and issues arises in the stores. The CRIV booklets are possessed by all user departments and since each booklet has a different sequence, the serial numbers do not serve their purpose.

In making requisition orders, authority is vested in a number of employees in the user department. This unlimited authorization has posed a problem in that other unauthorized personnel can fake authorities and acquire supplies from the

stores. The total number of authorities for requisition to the stores was as at June 1993 more than 50. This makes it difficult for the issuing stores clerks to ascertain the authenticity of the authorization due to the large number of authorities. This situation has largely contributed to the pilferage of stock supplies from the stores.

No clear assignment of duties exists in the stores. Clerks charged with the responsibility of issuing supplies, can also receive deliveries and also make entries in the bin cards and register. This provides a conducive environment of manipulating the bin-cards and pilfering the stores.

Security around the stores and in the stores is very poor. Although access is to be restricted to the stores staff, it appeared that it was open to many persons who were not stores staff. The security procedures at the gate are very poor. No inspection of personnel leaving the stores is conducted. Only the verification of the items issued to the agent is made. Furthermore, the security personnel at the gate are not conversant with spare parts. Thus the possibility of the wrong part leaving the stores premises is very high.

Management of the Nyayo Corporation has to seriously look into the stores area if it is to safeguard the resources of the corporation. The present system provides a lot of loopholes for supplies to be lost without any trace. The thefts that have occurred can largely be attributed to the poor internal control system that governs the stores.

4.2.2.12 The ledger section

CHAPTER FIVE.

All original vouchers both receipt vouchers and the payment vouchers are passed by the main cashier via a registrar to the ledger section for sorting and balancing whereby they are given batch numbers using control slips F.O.8 for receipts and F.O.9 for payments. The sorter signs for the accuracy of the net figure and how it is arrived at. It is the policy of the corporation that the cashier's net figure and sorter's net figure agree.

Sorted vouchers are then passed to computer section by the ledger section for keying in. A print out is then produced by the computer section to confirm accuracy of posting. The print-out is sent to the ledger section to confirm that vouchers keyed in are accurate ie Account No. Voucher No. date, amount e.t.c. Any adjustment to the print-out are communicated in writing to the computer section by the Head of the ledger section.

Final reformatted data is produced to confirm total accuracy in posting. Authority to produce the ledger is given by the head of accounting unit to the computer room. The computer statements produced are:

- a) Main ledger, giving details of voucher
- b) Trial balance
- c) Detailed item analysis
- d) Statutory control report

The 1st three reports are produced on a monthly basis.

CHAPTER FIVE.

CONCLUSION AND RECOMMENDATIONS

5.0 Introduction.

This study was conducted in the area of internal control with a specific reference to internal control system of Nyayo Bus Service Corporation, Nairobi. In reality, good internal control are a matter of degree and the individual component of an internal control system are merely an ideal. Furthermore in practice, the cost of operating the system must be weighed against benefits. This might mean some sacrifice of control procedures. The interest in studying the internal control system of the corporation emanated from the desire to have an insight into how a state corporation would function. It was also interesting to venture into evaluating the internal control system of a state corporation which has received a lot of accusations from members of the public and less attention from professional accountants because of their nature.

5.1 Conclusion.

It has been observed from the analysis conducted that the cash receipts as well as the cash disbursement areas bear fairly strong controls. This could largely be attributed to the fact that the government accounting system is still in operation in these areas. The same can be said for the purchase cycle. However, as shown by the analysis, there is still a lot to be desired from both the payroll and the stores accounting system.

Regarding the proposed organisational chart, there is still alot of information that has not been taken into account. A more elaborate organisational chart proposal

is necessary if all the positions in the corporation are to be reflected in the organizational chart.

On the other hand, the internal auditor is being underutilised. He is charged with the responsibility of performing routine control checks which are also performed by the Examination section. This has led to the duplication of efforts and the down playing of the internal auditors effectiveness and role.

The following sub-section will attempt to provide recommendations, to each section of the accounting system, based on a sound theoretical framework of internal control systems. The recommendation are not only geared towards the improvement of the existing system but also towards assisting the Nyayo Bus Service Corporation in its efforts to adopt a conventional commercial accounting system.

5.2 Recommendations

5.2.1 The Organisational Chart.

It is crucial to management to understand that organizational independence of departments allows an entity to plan for the future, to direct and control its current operations effectively. A plan of organization requires that the division of duties, responsibilities and authority be clearly defined. The effectiveness of such a structure would be achieved by having designated heads who are evaluated on the basis of performance of their respective departments. The departmental heads should be of equal rank and should report directly to the General Manager as shown by the proposed organisational chart. The organisational chart as stated earlier needs also to take into account all the subunits that exist in the corporation, such that the whole organizational structure is contained in the organisational chart. The partial

organizational chart in Figure 1 to 4 provided suggest a possible arrangement of the responsibilities, duties and division of authority that could be adopted by the corporation. However many other factors like the cost of adopting such a structure and operating efficiency consideration (e.g problems of interdependence) would need to be taken into account before the establishment of such an organisational structure.

A closer look at the proposed organisation chart in appendix 1 discloses that the internal auditor reports directly to the General Manager. This is a violation of a major principle of an effective internal control system that requires that the internal auditor should report to the highest office possible in the organisation. This could be the executive chairman or the board of director as shown in figure 1.

The job of the internal auditor should be to investigate and appraise the system of internal control and the efficiency with which the various units of the business are performing their functions, and report his findings and make recommendations to top management. The internal auditor should not be responsible for performing routine control procedures such as verifying each and every voucher. These functions are performed by the examination section. The internal auditor should design and carry out audit procedures that will test the efficiency of virtually all aspects of company operations.

FIGURE 1

SUGGESTED PARTIAL ORGANIZATION CHART
FOR NYAYO BUS SERVICE CORPORATION.

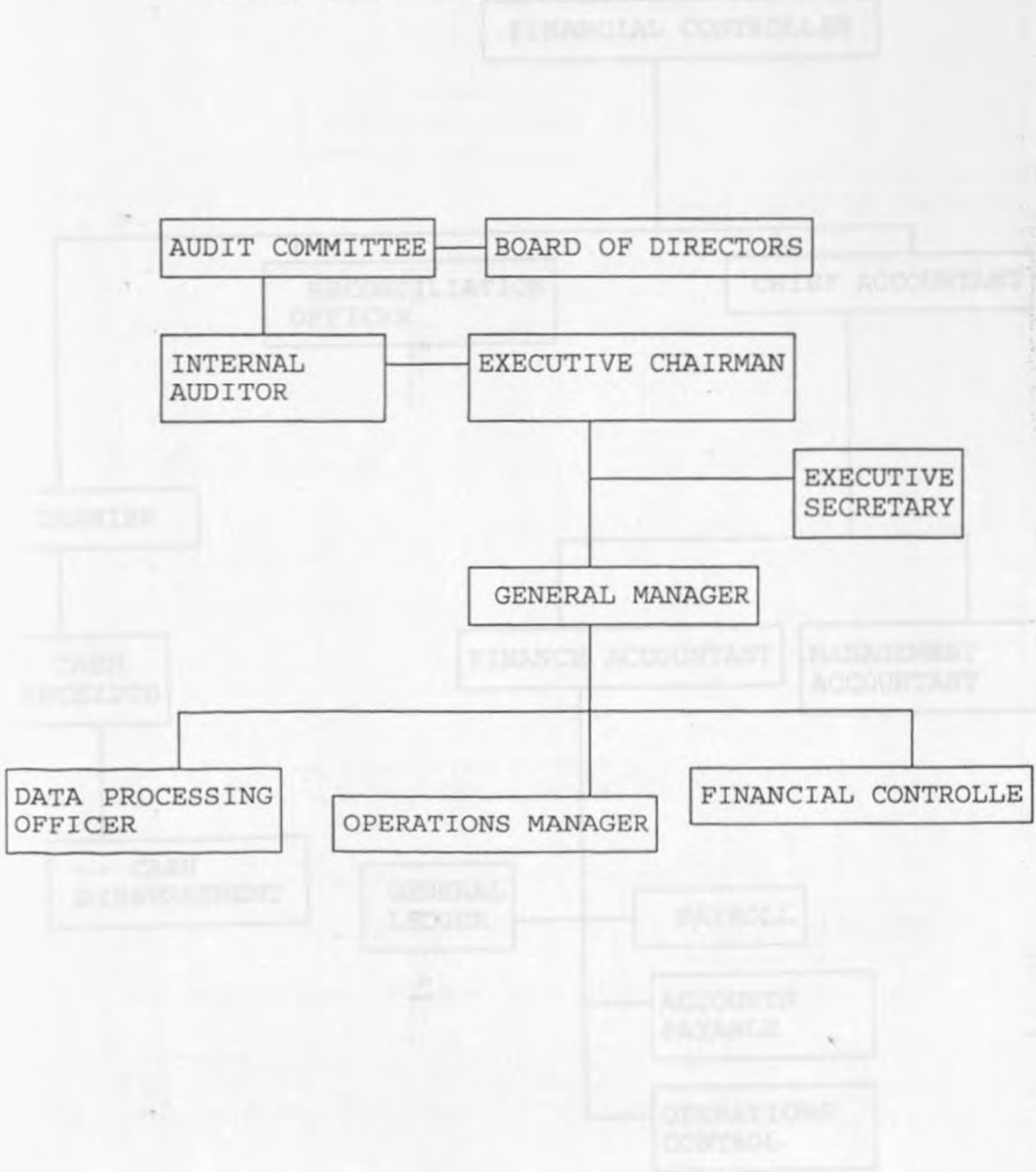


FIGURE 2

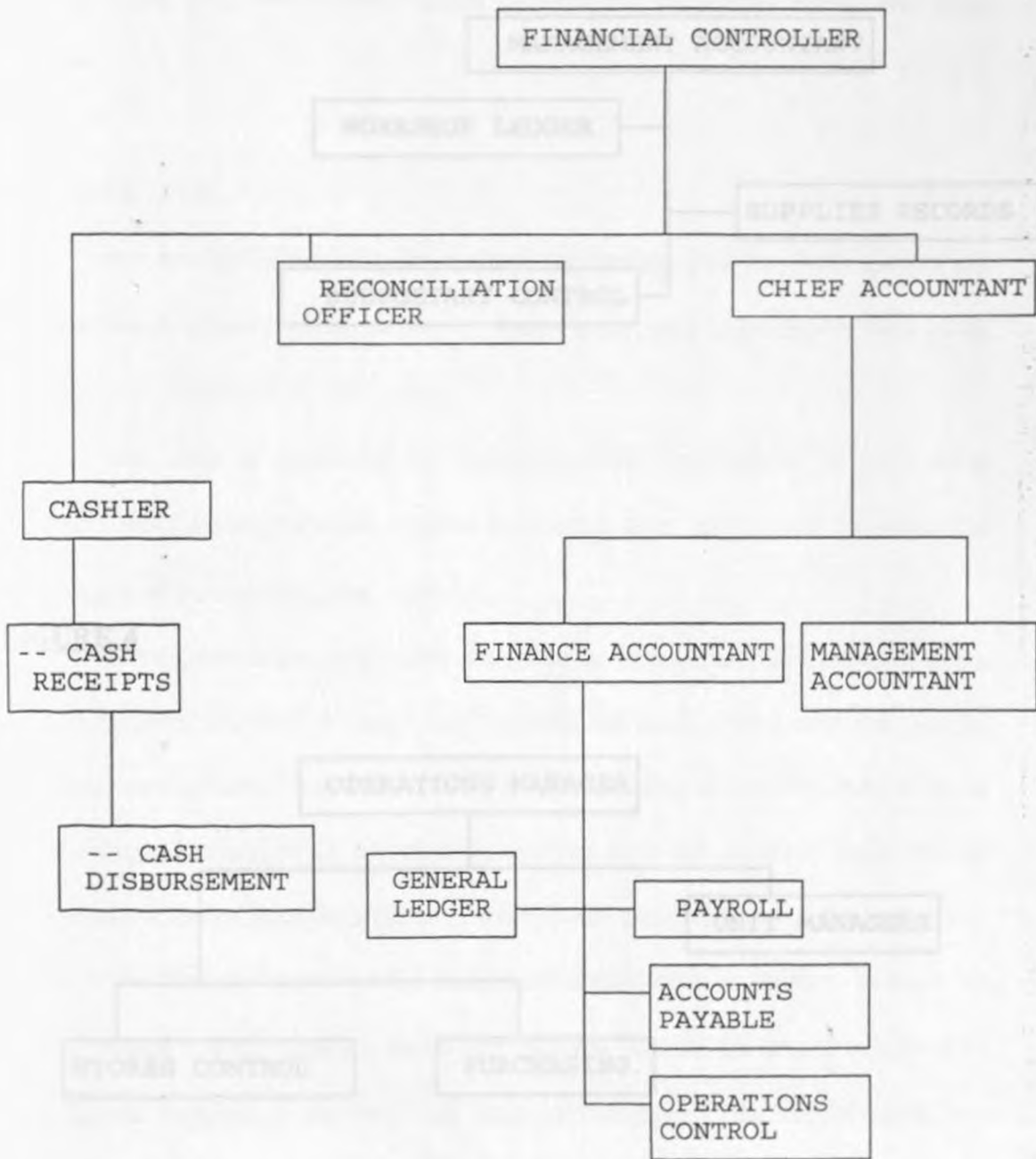


FIGURE 3

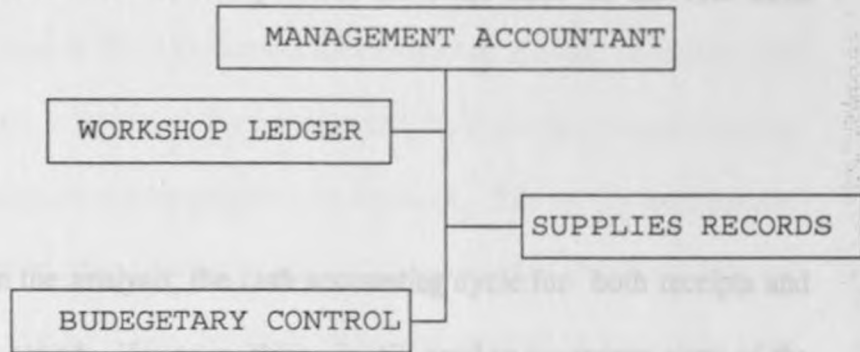
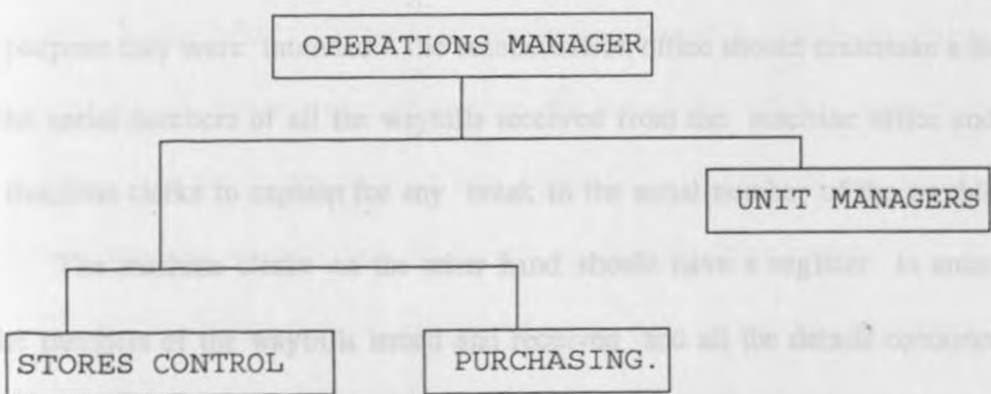


FIGURE 4



As for the vote book section, its usefulness will be outlived once the corporation assumes its required status. However, a budgetary control section should be instituted that would more or less perform the same tasks as the vote book section.

5.2.2 The Cash Cycle.

As observed in the analysis, the cash accounting cycle for both receipts and disbursement is fairly sound. However, there is still need to overcome some of the weaknesses that exist in the system.

The duty of producing the waybills should be assigned to the stores department or a stationary and supplies department so as to plug any loopholes that may exist in manipulating the waybills.

Strict controls and procedures should be instituted and communicated to the clerks handling waybills to ensure that waybills are handled with care and used for the purpose they were intended. The reconciliation office should undertake a listing of the serial numbers of all the waybills received from the machine office and ask the machine clerks to explain for any break in the serial number of the waybills.

The machine clerks on the other hand should have a register to enter the serial numbers of the waybills issued and received and all the details contained on the issued waybills at the time of issue and receipt. This would facilitate a cross-checking of the records of the reconciliation office and the machine office. It would also provide backup for any waybills that may be lost by the conductors.

Installation of corporate inspectors on routes is very crucial to the corporation in safeguarding its resources. Inspectors would not only limit the opportunities of

embezzlement of cash by the conductors but would also act as means of confirming that buses leaving the corporation's premises for the purpose of trade were actually trading.

In the handing over of the cash receipts by a cashier at the end of his/her shift to the taking over cashier, a listing of the receipts and the individual amounts should be prepared. This listing should be prepared in duplicate. The taking over cashier should then sign the listing after confirming the total receipts and receiving the cash from the handing over cashier. The duplicate should be retained by the taking over cashier while the original should be taken by the handing over cashier. This listing may be used as evidence of the handing over in case some irregularity arises.

5.2.3 The payroll system.

The paying of salaries using cash weakens the payroll controls considerably. The use of this practice encourages dishonest employees to engage in padding. From an internal control point payment to employees should be made by cheque. Payment by check, would make it possible for a separate salary account to be maintained. This would not only act as a control on the payroll but would also facilitate comparison between months for any changes that may appear.

While this system may be resisted by some staff, it should nevertheless be instituted and all employees should be required to open bank accounts.

A system also needs to be instituted that would facilitate the cross-checking of the print - out provided by the computer section. This system should also provide for the regular checking of wage rates, deductions and other personnel details.

5.2.4 The Purchase cycle.

The present practice of using a counter requisition and issuing voucher for requisitions should be discarded. Instead a local purchase requisition should be raised by the stores department in duplicate. This document should serve only one purpose of making a requisitioning request as opposed to the CRIV which was used for both requisition and issues. The original is to be sent to the purchasing office while the duplicate should be maintained by the stores.

In addition to the above, the practice of sending both the original and duplicate copy of the local purchase orders to the suppliers should also be discarded. Only the original LPO needs to be sent while the duplicate should be sent to the stores. This would enable the stores department to match the duplicate copy of the requisitioning order to the purchase order thus providing the receiving section with prior knowledge of what to expect.

The purchasing officer should also be discouraged from picking up goods from the suppliers premises. As a buyer, the corporation should not pick goods from its suppliers. This is to prevent any liability to fall on the corporation in the course of transporting those goods. The goods may get damaged or they may be stolen while on transit.

Suppliers who offer emergency services should be contracted by the management of the corporation. It should not be left at the discretion of the purchasing officer to decide on who to engage in providing such a service. The nature of the corporations transaction makes it possible for management to identify the classes of emergencies that may arise. In the case of tenders, access to the tender box should not be restricted to the purchasing officer. The tender box should

be opened by the purchasing officer and a member of the tender board on the morning of the tender board meeting. The tender box should be fixed with two different locks that would require both the authorized persons to enter their keys to the lock for the tender box to open.

This would ensure that no one person has an opportunity to manipulate any of the tenders. Since the tender box would be opened on the morning before the tender board meeting, it is very likely that all tenders received are going to be tabled to the members of the board meeting.

5.2.5 Stores.

The stores area bears the weakest controls in the corporation. The major weaknesses being the lack of segregation of duties, the lack of control accounts and the poor physical security.

Requisition orders to the purchasing department should be raised by the stores via a document whose usage will be strictly for raising requisition requests only. Serially numbered purchase orders should be prepared after authority from the tender - board has been received. Copies should then be forwarded to the accounting/finance department and the receiving section of the stores. This would require the establishment of a receiving section in the stores department. There needs to be a clear segregation of duties in the stores. The receiving section should be independent of the issuing section, storing section and recording section.

The copy of the purchase order sent to the receiving section should have the quantities blacked out to assure that receiving personnel make independent counts of the goods received.

All goods delivered to the corporation, should be cleared through the receiving section. The receiving section should be responsible for (1) the determination of quantities of goods received (2) determining whether the goods received are the ones ordered, (3) the detection of damaged or defective merchandise (4) the prompt transmittal of goods received to the storing section, and (5) the preparation of a receiving report.

As goods are delivered to the storing section, they should be counted, inspected and receipted for. The storing section should then notify the finance department of the amount received and placed in stock. In performing these functions, the stores department makes an important contribution to overall control of supplies. By signing for the goods, it fixes its own responsibility, and by notifying the accounting department of actual goods stored, it provides verification of the receiving department's work.

In making requisition requests, user departments should make use of a stores requisition note. Again, the stores requisition notes should be prepared in four copies. The 1st three copies are to be sent to the stores issuing section which is also the storing sections. Authority to make requisition requests should be limited to the departmental heads and their deputies. This will minimize the incidences of supplies leaving stores via faked signatures on CRIV. Due to the large number of user departments, it would be appropriate for the stores requisition note to be referenced when received by the stores department.

The 1st two copies of the stores requisition is to be retained by the stores department while the third copy would be attached to a gatepass that would be designed to include all the details contained into the stores requisition note and

details of the supplies issued. The 2nd copy of the stores requisition would then be sent to the accounting office.

Physical security needs to be improved both within and outside the compound of the stores. A system of identifying stores personnel should be instituted such that security personnel would only allow access into the stores to stores personnel. At the gate of the stores compound a register should exist that would require the security personnel at the gate to document all supplies leaving the stores compound, the details of the person leaving with supplies including his personnel no and identification no. Body inspection should also be conducted on persons entering the stores as well as leaving the stores.

5.2.6 Personnel

The hiring of qualified accountants is required to facilitate the strengthening of internal controls. Such personnel would be in a position to identify lapses in the systems and take remedial action on a timely basis. A training programme which may include sponsorship to account training institution or some in house training program would be useful for the improvement of employees whose experience has been in government accounting and not commercial accounting. This is inevitable since the proper functioning of any system depends on the competence and integrity of those operating it.

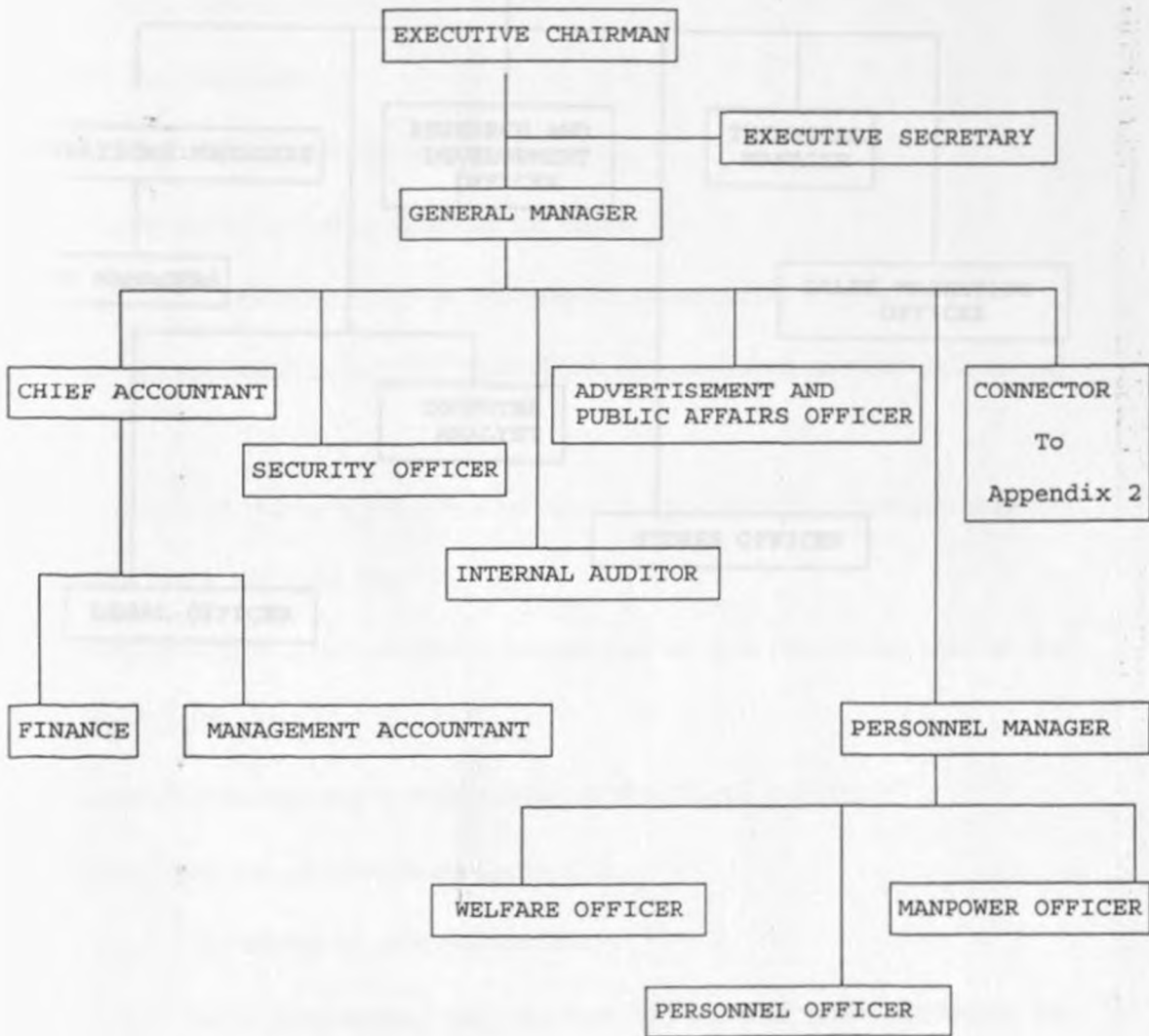
The establishment of sound controls does not by itself guarantee effectiveness. Unless the internal control receives constant attention, it tends to disintegrate. Members of management need to remain alert to the problems that may occur and make regular tests and investigations of those sections that relate to their immediate operating area.

5.3 Limitation of the study.

- (i) The outcome of the study cannot be generalize to other state corporations since the study is limited to Nyayo Bus Service Corporation, Nairobi.
- (ii) The nature of the internal control problems of the Nairobi office may not be the same as those of its branch offices thus the outcome of the study cannot be generalized to other branches.
- (iii) The study did not take into account the procedures involved in the transfer of resources to the branches by the head office and vice versa. The Head office was studied as a separate distinct trading entity.
- (iv) The evaluation of the fixed asset cycle, which contributes a large portion of the assets of the corporation, was not possible due to technicalities that exist in the course of the transition exercise from NYS.

PROPOSED NYAYO BUS SERVICE CORPORATION.

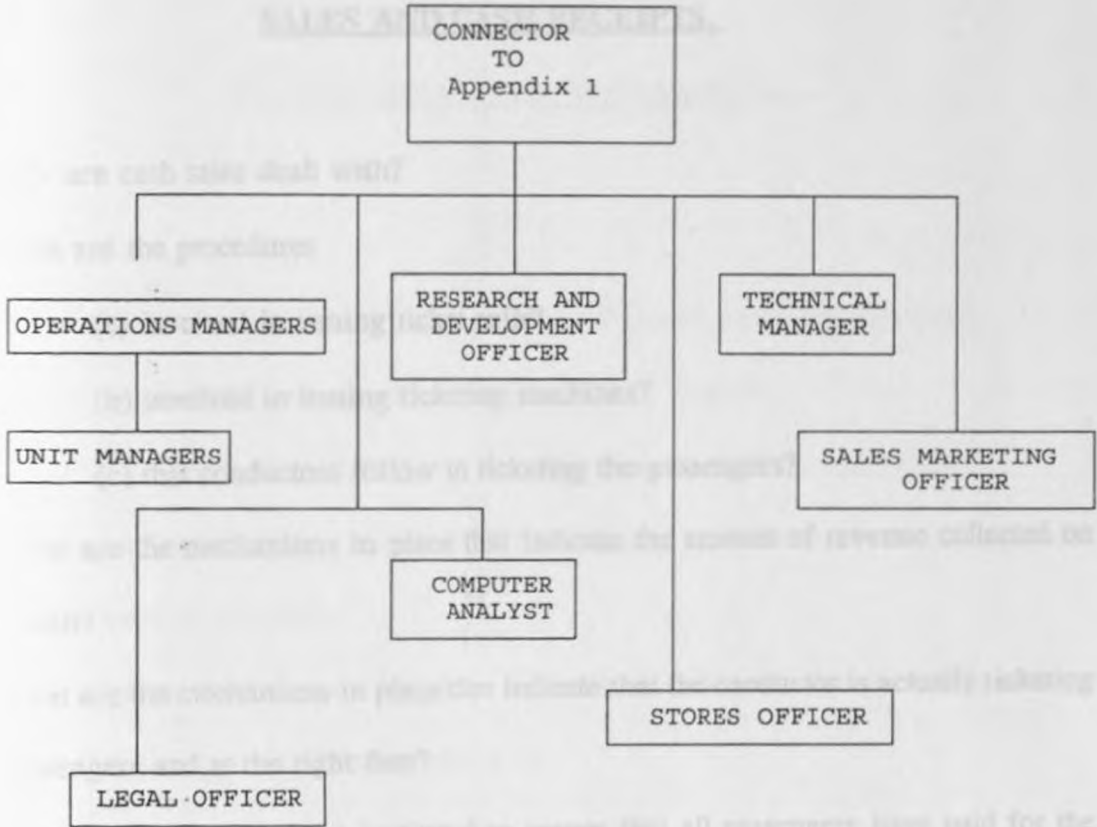
ORGANIZATIONAL CHART.



Appendix 2

INTERVIEW GUIDELINES

SALES AND MARKETING



...all passengers have paid for the ...
...offered?

...controls take the ensure management of the till roll is difficult?

...procedures and documents are involved in:

- (a) the receipt of cash and recording?
- (b) the control check and payments into the bank and recording in the cash book and ledger?

...are the returned ticket rolls and clearing machines dealt with after collection of ...
...receipts from the public?

INTERVIEW GUIDELINES.

SALES AND CASH RECEIPTS.

PURCHASES AND CASH PAYMENTS.

- A. How are cash sales dealt with?
1. What are the procedures
 - (a) involved in issuing ticket rolls?
 - (b) involved in issuing ticketing machines?
 - (c) that conductors follow in ticketing the passengers?
 2. What are the mechanisms in place that indicate the amount of revenue collected on a shift?
 3. What are the mechanisms in place that indicate that the conductor is actually ticketing passengers and at the right fare?
 4. What measures have been instituted to ensure that all passengers have paid for the services offered?
 5. What controls exist that ensure manipulation of the till roll is difficult?
 6. What procedures and documents are involved in;
 - (a) the receipt of cash and recording?
 - (b) the control thereof until payment into the bank and recording in the cash book and ledger?.
 7. How are the unused ticket rolls and ticketing machines dealt with after collection of day receipts from the conductors?

INTERVIEW GUIDELINES:

PURCHASES AND CASH PAYMENTS.

STORES

1. What are the procedures involved in the purchase of goods and services?
2. What are the laid down procedures for receipt of goods?
3. How is the processing of the invoices and setting up liability dealt with?
4. What are the laid down procedures for processing payments and recording payment in the book of accounts?
5. What are the methods used for claiming for short-deliveries, for damaged goods and ensuring that payment is not made twice?

PAYROLL

What are the procedures involved in developing payroll, who prepares it and how are employees paid?

APPENDIX 5

INTERNAL CONTROL QUESTIONNAIRE

INTERVIEW GUIDELINES

STORES

N/A Yes No Remarks

1. What are the procedures involved in controlling movement of supplies?
2. What measures are taken when receiving supplies, transferring supplies to warehouse and issuing of supplies?
3. How do you ensure that the supplies are used for the purpose of which it was requested?
4. Is the person who makes orders for supplies different from the person who records receipt and issues supplies?

PAYROLL

1. What are the procedures involved in developing payroll, who prepares it and how are employees paid?

INTERNAL CONTROL QUESTIONNAIRESALES

Questions	N/A	Yes	No	Remarks
1. Are ticketing machines serially numbered?				
2. Are ticket rolls issued only after authorization?				
3. Are ticketing machines issued only after authorization?				
4. Are all conductors required to sign for all ticket rolls and the ticketing machines allocated?				
5. Is there a system that controls movement and traces Machines to the conductor?				
6. Are the persons handling/issuing ticket rolls and ticketing machines authorised to do so?				
7. Are the equipment for receiving and recording cash adequate and conducive to good control?				
8. Are spot checks made by inspectors while busses are on route?				
9. Are surprise cash counts conducted while busses are on route?				

Questions

N/A Yes No Remarks

INTERNAL CONTROL QUESTIONNAIRE

10. Are all tickets serially numbered and receipts reflect amounts paid?

11. Are cash receipts from cash sales recorded by ticketing machine?

12. Are conductors required to enter sub-totals of cash indicated and number indicated by the ticket machine after every route?

13. Are totals of the ticketing machines verified by an employee not having access to cash?

14. Are prenumbered cash receipt vouchers raised for each submission of cash and a signed copy retained by the conductor?

- copy of the list turned over to all
- employees other than the cashier for comparison
- the cash receipt books?
- the collections deposited daily
- bank account?
- cash day's receipt deposited immediately
- without delay by an employee other
- than the accounts receivable bookkeeper?
- the duplicate deposit slips prepared filed?
- the duplicate deposit slips properly filed?

INTERNAL CONTROL QUESTIONNAIRECASH RECEIPTS

Questions	N/A	Yes	No	Remarks
1. Are all receiving cash authorised to do so?				
2. Is all incoming mail opened by a responsible employee who does not have access to accounting records and not connected to cashier's office?.				
3. Is a list of all incoming checks and responses prepared?				
4. Is a copy sent to the accounts receivable department for comparison with credit to customers accounts?				
5. Is a copy of the list turned over to an employee other than the cashier for comparison with the cash receipt books?				
6. Are the collections deposited daily in a bank account?				
7. Are cash day's receipt deposited intact and without delay by an employee other than the accounts receivable bookkeeper?				
8. Are the duplicate deposit slips prepared filed?				
9. Are the duplicate deposit slips properly filed?				

Questions

N/A Yes No Remarks

- 10. Are checks or other items returned by the bank delivered directly to an employee other than the cashier and promptly investigated?
- 11. Is the arrangement of duties and accounting records designed to prevent employees who handle cash from having access to accounting records?
- 12. Are all of the cash receipt lists and cash book checked for casts and cross casts?
- 13. Is there adequate control over the posting of cash receipt to the appropriate ledger accounts?

Summary

- 1. Can miscellaneous receipts be omitted?
- 2. Can cash balances be misappropriated or improperly used?

INTERNAL CONTROL QUESTIONNAIREPURCHASES

Questions	N/A	Yes	No	Remarks
1. Are all orders signed and originating outside the purchasing department?				
2. Are all goods ordered on the basis of signed requisitions?				
3. Is authorisation of purchase order done by someone other than the originator or custodian of supplies and are recorded on copies retained?				
4. Are authorisation limits specified?				
5. Are all purchase orders pre-numbered?				
6. Are goods inspected on arrival for quantity and description against the purchase order?				
7. Is there proper recording of goods received by the custodian of supplies?				
8. Are copies of pre-numbered received notes raised?				
9. Are copies of the goods received note sent to requisitions ordering and payment departments?				

Questions	N/A	Yes	No	Remarks
10. Are invoices received by a separate department from the buying department?				
11. Are invoices checked against purchase order and goods received notes?				
12. Are invoices checked for casts and extension?				
13. Are invoices approved after (11 and 12)?				
14. Is authority required to open new accounts in the credit ledger?				
15. Are creditor ledger balances reconciled to suppliers statement before and after payment?				
16. Are the total of creditors reconciled to the creditors control account?				
17. Are all purchase invoices matched in the same accounting period with goods received notes?				
18. Are all debit notes matched in the same accounting period with goods received notes?				

Summary

1. Can liabilities be set up for goods received which are either not authorized or not received?
2. Can liabilities be incurred but not recorded?

INTERNAL CONTROL QUESTIONNAIRECHEQUE PAYMENTS

Questions	N/A	Yes	No	Remarks
1. Are cheques drawn only against vouchers, remittance advice e.t.c?				
2. Is the function of drawing cheques independent from those of ordering, payroll preparation, approving invoices and signing cheques?				
3. Are at least two signatures required on cheques?				
4. Are they controlled as to limits of authority?				
5. Are cheques crossed and marked 'A/C payee' and 'Not negotiable'?				
6. Are unused cheque books kept in safe custody?				
7. Are authorized vouchers immediately stamped paid or cancelled?				
8. Are cheques mailed directly without being returned to the drawer of the cheques?				
9. Are there independent checks to ensure proper discounts are obtained where possible?				
10. Is the use of blank cheques prohibited?				
11. Are all of cash payment sheets and cash books checked for casts and cross casts?				

Questions**N/A Yes No Remarks**

12. Are all direct debits and standing orders checked for accuracy and authority?
13. Is there adequate control over the posting of payments to the appropriate ledger accounts?
14. Are the bank accounts reconciled with bank statements periodically?
15. Is there strict control for cheques drawn for cash?

Summary.

1. Can payments be made if not proerly documented or authorised?

INTERNAL CONTROL QUESTIONNAIREPETTY CASH FUNDS

Questions	N/A	Yes	No	Remarks
1. Is the responsibility of each fund vested in one person only?				
2. Is the custodian independent of other employees handling receipts?				
3. Is the amount of the funds restricted to require reimbursements at relatively short intervals?				
4. Is there a limit for an individual payment?				
5. Are payees required to sign pre-numbered vouchers for all pre-numbered disbursements?				
6. Are all advances made to employees properly approved?				
7. Is the cashing of personal checks prohibited?				
8. If not, are such checks approved for cashing by authorised persons?				
9. Are supporting documents checked at the time of reimbursement by a responsible employee?				
10. Does the employee verify the unexpended balance before approving reimbursement?				
11. Are amounts on vouchers written in words as well as figures?				
12. Are vouchers stamped after use?				

Questions

N/A Yes No Remarks

13. Is the fund checked by surprise counts made by an employee independent of the custodian?

N/A Yes No Remarks

Summary

1. Can petty cash payments be made if not authorised?

INTERNAL CONTROL QUESTIONNAIRE

PAYROLL

Questions	N/A	Yes	No	Remarks
1. Is the personnel department independent?				
2. Are the rates of pay, starters and leavers, change in rates of pay and deductions recorded and authorised by the personnel department?				
3. Is there as a mechanism for recording hours worked?				
4. Is bonus or over-time authorised by senior persons authorised to do so?				
5. Are wage rates checked regularly against personal records?				
6. Are wage rates, deductions and personnel details verified by independent persons other than the prepares of payroll?				
7. Is payroll signed by supervisor as authorisation of payment?				
8. Are cheques drawn by persons other than prepares of payroll?				
9. Are payrolls casted?				
10. Are cheques authorised by at least two directors?				
11. Are payslips, cash placed in sealed pay packets by persons other than payroll staff?				

Questions	N/A	Yes	No	Remarks
12. Is the wage payout made by persons who have no part to play in the preparation of payroll or making pay packets?				
13. Are staff collecting pay identified and sign for their pay?				
14. Is pay not collected banked by the cashier and investigated by personnel department?				
15. Is pay not collected held in a safe by cashier and is payroll department notified in writing?				
16. Are deductions from payroll authorised and credited to appropriate accounts?				
17. Is new payroll reconciled with last payroll?				
18. Are separate bank accounts kept for wages and salaries?				
19. Is payroll casted and cross- casted?				
20. Is the number of employees on payroll checked to personnel department records?				

Summary

1. Can persons other than genuine employees be paid through the payroll?
2. Can employees be paid for work not done or unclaimed wages?

- 3. Can payroll errors occur?
- 4. Can the payroll be inflated in otherways?

QUESTIONNAIRE

STORES

Question	N/A	Yes	No	Remarks
Are goods held in segregated, lockable areas under the custody of personnel?				
Are goods controlled by warehouse through recording documents on his terms which are independently verified by bank control accounts?				
Are there control accounts maintained by person who do not have access to physical stock and his responsibility is purchase either?				
Are goods received recorded on goods received notes?				
Are supplier receipts on property withdrawn from stock?				
Are receipts of goods based on authorized documents and are pre-numbered?				
Are there restrictions on authorized person?				
Are receipts of goods from suppliers made by goods received notes?				
Are regular reviews made for damaged stock?				
Are activities to write-off damaged goods occur from error, only after proper documentation?				

INTERNAL CONTROL QUESTIONNAIRE

STORES

Questions	N/A	Yes	No	Remarks
1. Are goods held in seggregated,lockable areas under the control of storeman?				
2. Are goods controlled by warehouse through recording movements on bin cards which are independently controlled by stores controll accounts?				
3. Are stores control accounts maintained by person who does not have access to physical stock and has no responsibility of purchase either?				
4. Are goods received recorded on goods received notes?				
5. Are supplies recorded on properly authorised requisition notes?				
6. Is movement of goods based on authorised documents which are pre-numbered?				
7. Is access to stores restricted to authorised person?				
8. Is receipt of goods from suppliers made by goods invalid section?				
9. Are regular reviews made for damaged stock?				
10. Does authority to write-off damaged goods occur from a senior, only after proper documentation?				

Questions	BIBLIOGRAPHIES	N/A	Yes	No	Remarks
11. Is authority to write off damaged goods limited?					
12. Are stock records reconciled periodically to physical quantities?					
13. Is the person who has custody of supplies different from the person who orders supplies?					
13. Does authority to write off damaged goods occur only after proper documentation?					
14. Are continuous stocktaking systems in operation as a basis for determining the physical accuracy of supplies?					

Summary

1. Can stocks be lost or pilfered?
2. Can stocks be used without proper recording?

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