

Internal control

[Business](#), [Accounting](#)



What is internal control and why is it important The American Institute of Accountants first defined the term internal control in 1949, followed by further clarifications in 1958 and 1972. In 1977 publicly held companies came under legislation to adequately implement controls to protect their financial information. A report by the Committee of Sponsoring Organizations in 1992 and the Sarbanes-Oxley Act of 2002 are more recent documents defining internal controls. (Bishop, 1991, p. 117-123; Colbert and Bowen, 1996, 26-35)This essay will describe and explain the internal control and discuss why is it important.

There are five points about the importance of internal control, which respectively are ControlEnvironment, Risk Assessment, Control Activities, Communicationand Information and Monitoring. There are two definitions about internal control . Frist, internal control the integration of the activities, plans, attitudes, policies, and efforts of the employees of a department working together to provide reasonable assurance that the department will achieve its mission. More simply, internal control is what a department does to see that the things they want to happen will happen and the evidences they don't want to happen would not happen. Manea Birza, 2012, p. 75)Second, the Committee of Sponsoring Organizations of the Treadway Commission (COSO)(2005) has claimed that internal control is process, effected by an entity's board of directors, management and other personnel , designed to provide reasonable assurance regarding the achievement of objectives in the following thing: effectiveness and efficiency of operations and reliability of financial reporting. One of important reason of why is it significant that is control environment.

The control environment, sometimes referred to as “tone at the top”, is the foundation for all other components of internal control. The control environment is influenced by management’s philosophy, operating style, integrity, ethical values, and commitment to competence. If this foundation is strong, if the control environment is positive, the overall system of internal control will be more effective, because the control environment component is the foundation upon which all other components of internal control are based, and it sets the tone of an organization.

A small business can have unique advantages in establishing a strong control environment. Employees in many smaller businesses interact more closely with top management and are directly influenced by management actions. Through day-to-day practices and actions, management can effectively reinforce the company’s fundamental values and directives. The close working relationship also enables senior management to quickly recognize when employee’s actions need modification. (Ratcliffe, 2005, p209 and Chuck Landes, 2009, p56) Two of important reason of why internal control is important that is risk assessment.

Risk assessment is the identification, analysis, and management of risks relevant to the achievement of the department’s goals and objectives. Risks include internal and external events or events that may occur and adversely affect operations. Once risks are identified, management should consider their impact or significance, the probability of their occurrence, and how to manage them. (Spencer Pickett and Pickett, 2010) Risk assessment, as it relates to the objective of reliable financial reporting, involve identification and analysis of the risks of material misstatement.

Establishment of financial reporting objectives articulated by a assessment process. Risk assessment in small businesses can be relatively efficient , often because in-depth knowledge of the company's operations enables the owner and management to have first-hand information of where risk exist. In carrying out their normal responsibilities, including obtaining information gained from employees, customers, supplier, and others, these managers identify risks inherent in business processes. (Ratcliffe, 2005)In this way , the risk assessment is quiet significant for company or enterprise.

Three of important reason of why internal control is important that is control activities. Internal control activities are tools - policies, procedures, techniques, and mechanisms - that help ensure management's directives are carried out. Control activities help identify, prevent or reduce the risks that can impede accomplishment of the department's objectives. Control activities occur throughout the department, at all levels and in all functions; they include activities such as approvals, authorizations, verifications, reconciliations, documentation, separation of duties, and safeguarding of assets. Root, 1998) Many smaller companies use certain compensating controls to achieve the objectives, when resource constraints compromise the ability to segregate duties. They help ensure that necessary actions are taken to address risks to a achievement of the entity's objectives. Control activities occur throughout the organization at all levels and in all functions. (Ratcliffe, 2005 and Chuck Landes, 2009)Control activities are one of most important in internal control.

Four of important reason of why internal control is important that is Communication and Information. Information systems identify, capture, and

distribute information supporting the achievement of financial reporting objectives. Information systems in small businesses are likely to be less formal than in large ones, but their role is just as significant. (Chuck Landes, 2009) For a department to run and control its operations, it must have relevant, valid, reliable, and timely communications relating to internal and external events.

Managers must be able to secure reliable information to make informed business decisions, understand their risks, and communicate policies and other important information to those who need it. (Rezaee, 2002) so, it is also integral for internal control. Finally, monitoring is most significant for internal control's reason why is it important. The department's internal control system needs to be monitored to assess whether controls are effective and operating as intended.

Monitoring occurs through routine managerial activities such as supervision, reconciliations, checklists, comparisons, performance evaluations, and status reports; monitoring may also occur through separate internal evaluations example internal audits/reviews or from use of external sources example comparison to peer groups or industry standards, surveys. Deficiencies found during monitoring need to be reported to those responsible for the function, with serious deficiencies being reported to top management. (Rezaee, 2002, p. 07) Committee Of Sponsoring Organizations (COSO) of the Treadway Commission have suggested that senior executives have long sought ways to better control the enterprises they run. Internal controls are put in place to keep the company on course toward profitability objects and achievement of its task, and to least loss. (Spencer Pickett, 2005) It reveals the important

of monitoring. In conclusion, there are many beneficial point to prove internal control is important because Pickett (2010) consider that the overall purpose of internal control is to help a department achieve its mission and reach certain goals and objectives.

An effective internal control system helps a department to promote orderly, economical, efficient and effective operations and produce quality products and services consistent with the department's mission and safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud and promote adherence to statutes, regulations, bulletins and procedures and develop and maintain reliable financial and management data, and accurately report that data in a timely manner.

Therefore, in many countries, internal control is very popular in different company or different government; however, it is not available in all of situations, because whether an organization achieves operational and strategic objectives may depend on factors outside the company, such as competition or technological innovation. These factors are outside the scope of internal control; therefore, effective internal control provides only timely information or feedback on progress towards the achievement of operational and strategic objectives, but cannot guarantee their achievement. (Rezaee, 2002)