Justification for an internal control system

Business, Accounting

Over the past years many organizations have fallen because of inadequate financial reporting and ineffective controls. To overcome this dilemma, the creation of the Sarbanes Oxley Act (SOX) of 2002 requires corporations to take full control over its financial reporting and accounting by placing internal controls within its organization. Internal controls not only establish the foundation of reasonable assurance for meeting company objectives but also provide functions in achieving other objectives. These objectives are operational effectiveness and efficiency, relevant and reliable financial data, and verify law and regulation compliance.

As a controller of this company one believes that internal controls are important for these areas to be successful. Although this business uses the insurance and portfolio approaches as controls to manage the association of risks with activities, one believes an internal control system would be more beneficial for this company. Current Approaches Insurance Approach Insurance is not as large as it can be for a company because it is a way of looking at the risk along with knowing that an acceptance of loss is present for a company.

Companies basically carry insurance policies to prevent and cover large liabilities from natural disasters or accidents. Under this approach management is stating an acceptance of a loss is present for a company when insuring the company, assets, or its employees. For a company using this approach protection is the only gain in knowing the company has insurance to make a claim to replace or receive monies for the loss

(McCarthy & Flynn, 2004, p. 75). However, the insurance approach is more of a tool for risk financing than a tool for risk management.

This is because this approach is reactive in mitigating the impact of a loss rather than preventive in protecting the company from a loss. This approach can be beneficial for the company if a company can find affordable insurance with deductibles the company feels comfortable with. This is because the company would only be responsible for paying the deductible and the insurance company would pay the rest in the event of a catastrophic disaster. Portfolio Approach Unlike, the insurance approach the portfolio approach has more structure and complexity.

This is because during the process of decision-making it gives more procedures and processes in making a decision (Thomas, 2002, para. 23). The main idea behind this approach is to maximize investments of a company while minimizing the risks of the company. Even though this approach organizes to an extent the decision-making process it does not provide protection assurance for the investment against risk. The portfolio approach is beneficial for a company when the company wants to measure the type of risk it wants to take on along with the likelihood of making a positive return on that risk.

Internal Control System To an organization a vital component to risk management procedures is a reliable internal control system. This system helps regulate, reduce lost, and minimize risks along with accomplishing the organizationalgoalsand success of a company (McCarthy & Flynn, 2004, p.

249). Benefits of an Internal Control System Generally the insurance approach is necessary for a company to overcome the risk of a loss. The portfolio approach is an effective approach but is more reactive than preventive.

Even though a business may have insurance and portfolio approaches in place these approaches are not efficient and cost-effective enough to protect the company from risks like an internal control system can. Internal control systems are unlike the insurance and portfolio approaches because these systems are proactive tools in risk management. This type of system ensures the protection of company assets through a system of policies and procedures. In addition, this system establishes reliability in financial data along with establishes compliance with laws and regulations set forth from regulations like the SOX Act.

These types of systems also help to improve internal and externalcommunicationprocesses within a company. Recommendation As a controller of this company, one recommends that management incorporates an internal control system into the company. This is because this system will be more beneficial to the company in the long-run than the current approaches the company already has in place. One believes an internal control system will help protect the company from uncertainties as well as ensuring the company is operating in proper accordance with its mission and goals.