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Limitations of Internal Control system

Internal control system is the process, which provides assurance to achieve objectives in the categories of reliability of financial accounting, efficiency and effectiveness of financial operations and compliance with regulatory laws. It also protects the data from unauthorized use of employees. In spite of the effective design of internal control systems there are several limitations, which include cost vs. benefit, judgment, breakdowns, management override and collusion . The cost required to setup an internal control system should not exceed its benefits. Restriction on the cost prevents the management from implementing an accurate internal control system, which leads to risks in the internal control system. It is important for the management to weigh all the risks, which are both tangible and intangible. Human judgment limits the effectiveness and efficiency of internal controls under pressure to carry on business depending upon the information at hand .

Breakdown is possible irrespective of the design of the internal control systems. Misinterpretation of instructions or mistakes committed by the employees leads to breakdown of internal control systems. Errors resulted from technology and complex computer information systems are also reasons of breakdown. Overriding standard policies and procedures for personal advantage or gain by the high level personnel apart from intervention of the management for legitimate purposes is also a limitation of the internal control system . Another limitation is employee circumvention. Circumvention of internal control system leads to the

alteration of financial data or information in such a manner, which is unidentifiable by the internal control system.

Examples of Internal Control Procedures

The two examples of internal control procedures are approval of purchase orders and review of journal entries. The approval process includes activation, workflow and versioning. The activation involves all purchase orders, purchase orders to individual vendors and specific vendors. Accounting workflow procedure dictates the flow of information or documents through the business operations of a company. The procedure acts as a basis for completing all the accounting functions. Larger business organizations use accounting workflow procedures as a mandate to make sure that the employees consistently handle all the financial information of the company. Accounting workflow procedure determines the guidelines essential for collecting internal and external documents, posting information into the accounting ledger and filing the information according to the standard accounting procedures. Versioning involves the creation of a new document on the approval of a purchase order. It makes sure to complete the audit trail to the changes made to a confirmed order.

Review of journal entries involves standard and non-standard recurring entries. Standard recurring journal entries include payroll accrual, revenue accrual and expenditure accrual. On the other hand, non-standard recurring entries are one-time entries rarely form a part of the journal entry process. It is important to identify unauthorized entries posted by individuals who are not responsible for such entries. Also, frequent corrections in the entries indicate unauthorized adjustments. Long gaps in dates indicate the

concealing of entries. Entries with same amount on the same date indicate duplicate entries . Entries posted in weekends and holidays indicate that the entries are not the part of the normal accounting routine. It is also important to review the amounts ending in 99 and amounts just below the threshold value. Rounded values and topside adjustments must have priority.

Symptoms of a Lack of Internal Control

The failure of the management to establish a suitable atmosphere to support the prevention of fraud and reward honest employees is the first symptom.

Employees are the basic reason for the fraud in companies. Validity and accuracy of data end in suspicion due to lack of internal control.

Accumulation of errors due to accidental processing of inaccurate data is possible due to lack of internal control . This symptom is unrecognizable unless the conduction of an audit takes place. Accounts payable is the first and foremost sufferer of fraud schemes. Customer service issues arise due to improper management of inventory results. Payroll discrepancies include posting fraudulent time sheets and incorrect overtime. False bills as a result of phantom vendor accounts and unauthorized purchases result in a rise of the level of expenses of a company in the income statements .

The Impact of Missing Journal Entry on the Financial Statements of the Company

The issues that arise from missing a journal entry in the financial statements depend on the type of the missing entry. The case in which a journal entry is a reclassification of an expense transferred from a single account, the missing entry does not matter much. However, a missing journal entry in a large financial action causes severe harm. The incorrect display of a

correctly stated balance results in misleading information and creates confusion leading to incorrect decision making . Similarly, not posting an entry for the amount paid into the account causes equal problems, such as unnecessary friction among the companies. The impact of a missing entry also depends on what is at stake due to the missing entry. A missing entry alters the profit or loss of a company, which affects the credibility and future actions of the company.

Works Cited

Juan, D. A.-S. (2007). Fundamentals of Accounting: Basic Accounting Principles Simplified for Accounting Students. AuthorHouse.