

# [Course work on accounting internal controls](https://assignbuster.com/course-work-on-accounting-internal-controls/)

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## Limitations of the Internal Control Systems

According to SA 400/AAS-6 Risk Assessments and Internal Controls, internal control systems can provide only reasonable, but not absolute, assurance that the objectives of internal controls are achieved because of the following inherent limitations (Ainapure& Ainapure, 2009)
Managements may attempt to keep the cost of an internal control below its expected benefits

## Most internal controls are directed at usual transactions

There is a possibility of human error due to carelessness, misunderstanding, lack of knowledge etc.

There may be collusion among employees and/ or outsiders.
A person responsible for exercising an internal control may abuse that responsibility.
Procedures may become inadequate due to changes in conditions.
Compliance with procedures may deteriorate such like when controls fail to capture or flag unusual transactions.
There may be manipulations by management.

## Examples of Internal Control Procedures, and their Implementation

Roth, (1997) describes Internal Control as any action taken by an organization to help enhance the likelihood that the goals and objectives of the organization will be achieved. However, control procedures are the policies and procedures established to achieve these objectives, they include:

## Physical control over assets and records

The Company’s management must develop ways to analytically identify and manage the potential risks that could hinder or prevent the organization from being profitable. This involves restricting direct access to assets, records and information; and by comparing the results of physical verification of assets (cash etc.) with corresponding accounting records.

## Personnel

Without management support, employees will not take the time to implement and follow internal control procedures. Therefore, they must drive the organization toward a controlled environment by enforcing strict and highly visible consequences in the event of a failure to comply with internal control procedures.

## The management should enforce proper procedures for authorization.

This is by reporting and reviewing reconciliations e. g. bank reconciliations, and by maintaining and reviewing control accounts and related subsidiary ledgers

## Adequate documents and records

This is achieved by controlling computer information systems, checking the arithmetical accuracy of the records, and approving and controlling of documents

## Adequate separation of duties

In order to make internal controls effective, upper managers need to clearly identify the activities each department needs to do in order to be in compliance with stated internal control objectives.

## Independent checks on performances

The management should try comparing internal data with external sources of information and analyzing the financial results with corresponding budgeted figures

## Symptoms of a lack of Internal Control

According to The Institute of Internal Auditors Research Foundation (2010), a practical means of identifying potential risks or weaknesses due to lack of internal controls is by ascertaining the following:
(1) Poor authorization practices by the management, (2) improperly designed records, (3) Missing documentation as a result of insecurity of assets and records, (4) lack of periodic reconciliations and verifications, (5) poor analytical review, (6) and preparation of financial reports that do not conform with generally accepted accounting principles.

## Impact of the missing journal entry on the financial statements of the company

Insurance prepaid being a prepaid expense should be recorded as assets in the company’s financial records until it is consumed (Nurre, 2011). However, an adjusting entry of prepaid insurance totaling to $1500 was not recorded for the first 3 months. Notably, an adjusting entry for prepaid expenses will result in an increase (a debit) to an expense account and a decrease (a credit) to an asset account. Therefore, the impact of the missing adjusting journal entry means that the balance sheet account will be understated and the income statement account overstated by an equal amount. Summarily, this missing adjusting journal will indicate an overstatement in earnings and an understatement in liabilities of the company’s financial statements.

## Reference

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