

Justification for an internal control system



Justification for new system when controls exist in the insurance and portfolio approach The need for new system of internal control has developed primarily because in the fast changing environment of globalization, business compulsions have become more stringent in their nature and factors like accountability, responsibility and reliability have become important pre-requisites for business to create a credible environment for their trade and investment. The lack of effective controls vis-à-vis malpractices in accounts and auditing, security of confidential information, corrupt practices in the higher hierarchy of management, disparity in rules and regulation etc. have become crucial risks factors that have resulted in huge economic loss for its shareholders as well adversely affecting its credibility in the market.

Another factor is that the increasing dynamic business environment and the volatility in the market have greatly increased the risks to the interests of the stakeholders. Risks have been defined as ‘ the possibility of loss as a result of the combination of uncertainty and exposure flowing from an investment decision or a commitment’ (Boritz, 1990). All the factors and element of governance, that adversely affect and dilute the rights of the shareholders and other stakeholders of the organization, are risks that need to be addressed urgently. Hence, effective internal control system has become the need of the hour.

Why current approach is valid but new system would be more beneficial The current approach is valid because the insurance and portfolio approach is partially equity linked and relies on the dynamic allocation of portfolio such that the stakeholders are protected by guarantee of minimum wealth at a specified time period (Basak, 2002). Though the current approach helps

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safeguard assets, the highly competitive nature of emerging new models of global business has increased the risks and responsibilities of the organizations. The existing system also lacks transparency that not only corrodes the trust of the investors but it also has long term repercussion on market credibility and performance outcome. The global financial crisis and recessive trends require more control mechanisms to meet the challenges of the changing paradigms of the global business that have considerable impact on the confidence building processes of the capital market.

The new system of internal control is designed to boost the confidence of the investors and improve market credibility and performance outcome. The internal controls of the company are various inter-related processes within its different departments which facilitate smooth operation, conforming to the prescribed parameters of managerial and policy controls. The Turnbull report says that the aim of framework of internal controls is to ‘ reflect sound business practice whereby internal control is embedded in the business process’ (Turnbull Report, 1999, para. 8). The new system would provide more transparency through dissemination of information thus significantly reducing risks. It can, thus, be concluded that an effective internal control system would not only promote transparency and better governance but it also help to inculcate confidence and trust amongst the various stakeholders.

Reference

Boritz, J Efrim. (1990). *Approaches to Dealing with Risks and Uncertainty*. CICA. Toronto, Canada.

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