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Strengthening the Capacity of Professional Accountants and their organizations in financial management.

[INTERNAL CONTROL ASSESSMENT]

Conducting internal control assessment is important to.....

Darith Khun, ACCA
Founder and Chairman

Mobile: +855 99 554 455
Email: director@professionalaccountants.org
www.professionalaccountants.org

Internal Control

2.1 Definition

- 1.1.1 Internal Control is any action or procedure(s) taken by the management or the board of director to enhance the risk management and to increase the likelihood that established objectives and goals can be achieved.
- 1.1.2 It is also defined by the American Institute of Certified Public Accountants (AICPA) that “internal control comprises that plan of organization and all of the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.”

2.2 Purpose of Control System

- Control systems are established by management to assist in achieving the orderly and efficient conduct of the business and to improve the likelihood of meeting business goals.
- Control systems are made up of a number of separate controls. Controls are designed to ensure that management decisions are correctly carried out and to prevent or detect errors or irregularities. They are also intended to safeguard assets information from loss or misuses.

2.3 Categories of Internal Control

Internal controls are classified in different ways by different people. They can be categorized into 2 categories: Administrative Controls and Accounting Controls; or into 3 categories: Control Environment, Direct Controls and General Controls.

Two categories of Internal Control:

1. Administrative Controls: the administrative controls include the plan of organization, the procedures and records that are concerned with the decision processes leading to management’s authorization of transaction. Such authorization is a management function directly associated with the responsibility for achieving the objectives of the organization and is the starting point for establishing accounting control of transactions.
2. Accounting Controls: comprise the plan of organization, the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records.

Accounting controls are designed to provide reasonable assurance that:

- Transactions are executed in accordance with management’s general or specific authorization.



- Transactions are recorded (1) to permit preparations of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets.
- Access to assets is permitted only in accordance with management's authorization.
- The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Three categories of Internal Control:

1. Control Environment: it establishes the conditions in which the control system operates and contributes to compliance with controls and the prevention and detection of errors and irregularities. It reflects the overall attitude, awareness and actions of the board of directors, management, owners, and others concerning the importance of control and its emphasis in the entity.
2. Direct Control: these are controls and computerized processing functions designed to prevent or detect errors or irregularities. They fall into three main groups:
 - a. Management and independent controls: these controls are applied to the results of transactions processing activities. (eg. Review, analysis and follow up of financial statements by the superior or the accounting manager)
 - b. Processing controls and computerized processing functions: various steps in a business transaction, from initiation until the preparation of a report are built into the computerized system of the organization, so that they can be relied upon as if they are controls.
 - c. Controls to safeguard assets: ensure that the assets are safeguarded from direct and indirect access through the ability to generate documents that authorize the use or disposal of assets. They are primarily concerned with the custody of assets and security measures.
3. General Control: These controls contribute significantly to the effectiveness of direct controls. They consist of:
 - a. Segregation of duties
 - b. Computerized information systems (CIS) department controls.

2.4 Management Responsibility for Internal Control System

The management of an enterprise is responsible for establishing and maintaining information, accounting and control systems that ensure the orderly and efficient conduct of the business and reduce related risks to acceptable levels. More specifically, management is responsible for developing systems that enable it--

- To plan, operate, and manage its business effectively and efficiently;



- To provide reasonable assurance that management decisions and policies are properly implemented;
- To recognize business problems on a timely basis;
- To properly record and account for business transactions and activities;
- To prepare proper financial statements and related notes, and comply with statutory requirements;
- To establish limits to which various staff can commit the company; and
- To safeguard assets and information from misuse and misappropriation.

The system of internal control should be under continuing supervision by management to determine that it is functioning as prescribed and modified as appropriate for changes in conditions.

When an entity has an internal audit department, the review of internal control may be supervised by this department if management so delegates.

2.5 Internal Control Responsibility of Internal Auditing

Internal Auditing has been defined as a managerial control one that provides an additional measure as to the effectiveness of other controls. To be effective as a managerial control, internal auditing must fulfill the following internal control responsibilities:

- Evaluate the organization's system of internal control, including computer based controls and data security and disaster recovery procedures, to determine that they are: (1) appropriately designed, (2) functioning as planned, and (3) updated as necessary to meet changes in operating conditions.
- Evaluate operating and administrative procedures and recommend improvements.
- Provide consultative assistance on the internal control and data security aspects of new computer based systems.
- Monitor compliance with codes of employee conduct
- Coordinate with external auditors regarding their financial statements audit.

2.6 Elements of a Satisfactory Internal Control System

- A plan of organization, which provides appropriate segregation of functional responsibilities.
- System of authorization (existence of a system)
- Adequate recording procedures and forms (documentation)
- Sound practices



- Adequacy of personnel. (Competent people)

2.7 Control Effectiveness Imperatives

Essential to the effectiveness of controls performed by individuals are:

- Independence in performance
- Competence of persons performing controls.
- Due care in doing the job.
- Critical appraisal and feedback through reporting and correction of deviations from required performance.

FROM TIME TO TIME, IT IS IMPORTANT THAT THE ORGANIZATION TO CONDUCT THE INTERNAL CONTROL ASSESSMENT TO VERIFY TWO IMPORTANT ASPECT OF CONTROLS:

1. IF THE INTERNAL CONTROL SYSTEM IS ADEQUATE
2. IF THE INTERNAL CONTROL SYSTEM IS EFFECTIVE.

Prepared by: Darith Khun, ACCA

