

The importance of the Internal Controls in Preventing abuse within Organizations

by *Costina Constantin*, Fellow Chartered Certified Accountant (FCCA)
Certified Internal Auditor (CIA)
Financial auditor

Almost all organizations use internal control systems, i.e. packages of measures implemented in order to meet its business objectives. These measures aim at protecting assets, establishing clear responsibilities and accountability within organization, reporting timely and correctly on its results. Such measures range from internal rules and procedures regarding the security of, and the access to the assets owned by the organization, to rules regarding the conduct of the employees.

Nonetheless, such measures do not guarantee that the risk of abuse, either by fraud or risk of misconduct are fully eliminated. The main purpose of the internal control system is to reduce such risks up to an acceptable or manageable level and to implement a mechanism of detecting imminent errors or cases of abuse.

The management of the company is responsible for ensuring such controls. The verification of the operational efficiency of internal controls is usually performed by way of an **internal audit**.

Cases of abuse

Abuse can affect all types of organizations regardless the size. When such cases occur, they lead to significant consequences, from financial losses to losing credibility and reputation. The most important categories include:

- Defalcation/embezzlement
- Corruption
- Fraud regarding financial statements

The most frequent one is the asset misappropriation by way of defalcation/embezzlement and it is related to the access of individuals (employees for instance) to the assets and financial resources of the company. The other two categories– corruption and fraud regarding financial statements- are less common in the private sector, but, when they occur, the impact is tremendous. In the public sector on the other hand, corruption linked to officials and politicians is more frequent.

Control systems

In order to prevent abuse, companies have to implement preventive and detective control measures. Preventive controls are meant to prevent misconduct and illegal behaviour and detective controls have the purpose of identifying inconsistencies, errors and suspicious situations only after their occurrence.

Once implemented, the management must ensure that these controls are fully operational within the organization and are followed by all employees, regardless of their position within the company. Besides implementing internal controls, it is also very important to regularly

check to what extent they are still appropriate and to update them whenever the processes of the organization undergo changes.

In designing the internal controls of an organization, the management must consider the following:

- **Segregation of duties**

One of the most important ways of preventing and identifying abuse, especially in smaller organizations without an organizational structure to allow proper segregation of duties, is restricting and monitoring the access of employees to both financial resources and accounting records.

- **Protecting company's assets**

Besides securing company's goods, implementing a double-signature form of approving bank transactions is the most common and the easiest way to control the access to the company's resources.

- **"four-eyes principle"**

The review performed by a manager of the measures taken by an employee – especially relating to issuance of credit notes, discounts, bank transactions and the preparation of the financial reporting – is key to both ensuring accountability for the correctness of the respective measure and to preventing abuse.

- **Monitoring other abuse indicators**

Corruption within a company can occur in relation to awarding a major contract to a supplier or customer or making favors to a business partner in exchange of bribe. Any noticeable change in the lifestyle of an employee may be a sign of unlawful gains.

The circumstances which may lead to abuse are those linked with targets hard to achieve, low salaries, avoidance by employees to take vacation, or repetitive corrections in the accounting records.

Conclusion

Experience indicates overall that the benefits of appropriate, effective internal controls outweigh the costs and effort for implementing such controls. The bottom line would be that they allow the management to focus on the core business.

Contact and further information:



STALFORT Legal. Tax. Audit.
Bucharest – Bistrița – Sibiu

Office Bucharest:

T.: +40 – 21 – 301 03 53

F: +40 – 21 – 315 78 36

M: bukarest@stalfort.ro

www.stalfort.ro