Accounting internal control mechanisms as a function of organization management

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Abstract- In contrast to the complexity of business processes, management today has at its disposal a whole set of internal control mechanisms. Internal control mechanisms need to be used both individually and mutually adapted to the legal needs and the needs of your company.

The quality of implementation varies from company to company, from country to country. It is the result of the degree of application of scientific and own knowledge, in the process of harmonizing with the best world practice.[1]

Modern business is characterized by a fast pace of work and a large amount of information. Good management depends on the quality of connections and the synergy of the four main elements of the organization's management: the supervisory board, management, external and internal audit. For the successful management of the company, the management needs timely and reliable information that helps to detect problems, ambiguities and threatening crises that need to be resolved in time, thus improving the business and increasing the efficiency and profitability of the business.

Index Terms- business.quality.company.audit.implementation

I. Introduction

It can be said that managing a company, in successful direction, is a very complex activity regardinng today's very dynamic business conditions and major economic crisis, which is possibly, a major opsticle. In such conditions, every activity with a goal to manage a company, often puts a lot of pressure on capital owners and managers, as well as on management processes themselves. Increasing competition, finding internal reserves, the need to reduce costs, all this creates a pressure.

All of the above urged need for effective and efficient management, as integral elements of today's economy. Usually, survival of company depends on its ability to mark, understand and respond to all possible threats quickly on the way to its survival and development, all for the purpose of achieving its goals.

Just performing an activity efficiently does not mean that the desired result has been achieved, so achieving the desired results (being effective) in an inefficient way represents bad management (for example, the goals are achieved, but at very high costs). Considering management through parameters such as efficiency and effectiveness, we can conclude that bad management is reflected in the failure to meet the intended goals and inadequate use of resources.

In the existing literature in the field of business control and auditing, internal controls are divided into two groups:

- accounting controls and
- administrative (management) controls.

Knowing this classification of internal controls, managers of companies or individual control services within the organization will be able to more easily choose, in a specific situation, the type of internal control that will give the best results, that is, which will be the most effective according to a certain situation.

Managerial tasks in organizations are carried out by ***managers***. Managers direct the execution of jobs and tasks performed by other people. Managers should enable other people to do their jobs more successfully and more.[2] In accordance with their role and place in the organization, they take care that the work is carried out efficiently and effectively. They achieve this by considering what needs to be done, how the planned work should be done, coordinating activities and monitoring and controlling the implementation of work. Some managers, in addition to the aforementioned jobs, also work directly on the implementation of

[1] Internal controls, ACCA Think Ahead, The global body for professional accountants, https://www.accaglobal.com/gb/en/student/exam-support-resources/fundamentals-exams-study-resources/f1/technical-articles/internal-controls.html

[2] Jennifer Herrity, What Is Management? Definitions, Functions and Styles, Career Guide, December 12, 2019., https://www.indeed.com/career-advice/career-development/what-is-management

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certain activities, that is, they also have operational responsibilities.[3]

Internal controls help management to control various processes, of which financial reporting, efficiency of business processes and compliance with laws and regulations are particularly important. System functioning and management efficiency is based on good control. In the business operations of companies and the public sector, frauds and errors occur as a result of a lack of adequate control, the desire to get rich quickly, a tendency towards crime and various other motives.[4]

II. Auditing

The first internal control mechanisms in companies can be linked to the emergence and study of the accounting system. Therefore, accounting system can be considered the forerunner and basis of the external and internal control mechanisms later based on it, and derived from it. Derived control mechanisms based on the accounting system are primarily management accounting, or controlling as it is popularly called today. Then, based directly on the accounting rules, there is an audit, both external and later internal.

Auditors and accountants often play a major role in creating a control system that, through adequate division of responsibilities, good organization and training of employees, becomes the best strategy for preventing the appearance and occurrence of fraud and errors. The internal control system includes internal control, internal audit and risk management, but internal control is continuous, massive and for that reason the most important. Certainly, this multiple importance can be realized if the internal control functions in the right way.[5] Management is responsible for that aspect, which should establish the right measures, procedures and rules, but also to constantly examine how they are carried out and submit a report on this to interested parties.

In the life cycle of every company, or entity, various risks threaten, and at the same time there are various chances, or opportunities. The condition for the survival of the company should be sought in itself, by combining the use of its existing or potential resources, for the application of which one should additionally invest a little more of one's own effort.

The successful setting up and maintenance of internal control system, understood in the broadest sense, represents that additional effort of the company, which needs to be done in order to ensure business continuity. The development and improvement of internal control instruments, in particular, have gained importance since the mid-nineties of the last century. They are additionally updated at the beginning of the XXI century, through modern ERM (Enterprise Risk Management) risk management models.[6]

Financial management and control (internal control) include the entire system of financial and other controls, including the organizational structure, methods and procedures, not only financial systems, but also operational and strategic systems of the organization. Financial management and control represent the entire system of internal controls established by company managers, who are also responsible for that system. Established controls, through risk management, provide assurance to a reasonable extent, that when achieving the company's goals, funds are used in a correct, ethical, economical, effective and efficient manner. This includes compliance with laws and other regulations, safeguarding funds against loss, misuse and damage.[7]

Employees and managers in their daily and formal, as well as informal, communication during the execution of work tasks, in fact, they carry out the risk management procedure. It is necessary to arrange or formalize the process of risk management, of course, not only to formalize it, but to essentially apply it based on the agreed rules. Then we can talk about a systemic approach to risk management. That is, if there are no formalized rules and no organized management of the risk process, then management is reduced to a case-by-case situation, or from need to need.

Accounting system is one of the main components of company's internal control system. The basic principles and principles of the accounting system are legally regulated. We think of the accounting function as a function that is primarily responsible for the correct and timely recording of business changes, and therefore also for providing detailed and accurate information about them.[8]

Accounting internal control is the most important and extensive part of the internal control of a business entity because accounting is the central place where every business transaction is monitored and recorded and where the information needed by the management for quality management is generated and decision are made. Internal accounting controls mean organizational measures, methods and procedures established by the business system

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[3] Satyendra Kumar Sarna, Lower level Managers and their Role in Organizational Functioning, February 18, 2022., Ispat Guru, https://www.ispatguru.com/lower-level-managers-and-their-role-in-organizational-functioning

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[8] Jason Fernando, Accounting Explained With Brief History and Modern Job Requirements, https://www.investopedia.com/terms/a/accounting.asp, July 04, 2022

through its normative acts in order to prevent illegal deviations in business. [9]

Controlling or management accounting is the process of using accounting data for decision-making purposes. It combines certain parts of financial accounting and cost accounting, presenting exactly the data that is important for business decision-making. Controlling is an advisory function, it warns of bad trends before they happen. Controlling is, in a way, management accounting projected into the future and therefore a very useful system of tools for the chief manager and management.[10]

Financial management and control (internal control) covers the entire system financial and other controls, including organizational structure, methods and procedures, not only financial systems, but also operational and strategic systems of the organization. Financial management and control represent the entire system of internal controls established by company managers, who are also responsible for that system. Established controls, through risk management, provide assurance to a reasonable extent that goals are being achieved companies use funds in a correct, ethical, economical, effective and efficient manner. This includes compliance with laws and other regulations, keeping funds from losses, misuse and damage.

III. Instruments of Corporate Governance

Effectiveness and efficiency of corporate governance can be achieved by applying different instruments, which can be divided into internal and external. The most frequently mentioned external instruments of corporate governance are:

- the corporate control market;
- market of products and services;
- market of managerial services and
- legal regulation.

The most frequently mentioned internal instruments of corporate governance are:

- monitoring of management by the administrative and possibly supervisory board;
- appropriate incentive systems for managers;
- internal audit and control by large institutional investors.

External instruments are a set of state measures, legal regulations, external audit of financial statements, state audit and the influence of anti-corruption agency measures. The internal instruments in the focus of this research are the financial management and control system (FMCS), integrated management systems (IMS), business risk assessment (BRA), internal control system (ICS), accounting system (AS), modern information system (ERP), and thereby supported fast closing of the accounting period (FAST CLOSE), internal audit (IA) and Controlling (CO).

A standard system of internal control that would suit the needs of all companies does not exist because the company's operations are conditioned by individual determinants such as: type of activity, size, location and so. Quality of internal control depends, especially in large companies, on these basic factors:

- organizational structure of the company, [11]
- adequate accounting structure, [12]
- internal audit [13] and
- personnel [14].

Financial management and control,[15] as a system, consists of five fundamental mutually related elements:

1. control environment,
2. risk management,
3. control activities,
4. information and communication,
5. monitoring and evaluation of the system.

IV. Enterprise Resource Planning

Internal control is a process carried out by the entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives relating to activities, reporting and compliance. It is realized by the people in the organization, by what they do and say. People determine the goals of the organization and put control mechanisms into operation. When internal control is evaluated, it is actually the process and not the outcome that is evaluated. There is a connection between but an effective process is likely to lead to the desired outcome. An unwanted outcome is an indication that the process has flaws, but this relationship does not always have to be correct. A failure in internal control can be attributed to something other than a flaw in the process.

The basic quality of the ERP (Enterprise Resource Planning) system is a set of different modules between which there is complete integration. The mentioned softwares enable the establishment of control over the entire business, better availability of information, increase in efficiency and productivity, faster response to market demands. In other words: ERP software integrates the departments and functions of the company into a single program that is executed in a single database, which represents an important step forward in improving efficiency, because the integration speeds up the business process. [16]

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[9] Will Kenton, Internal Controls: Definition, Types, and Importance, September 03, 2021, https://www.investopedia.com/terms/i/internalcontrols.asp

[10] David Ingram, Basic Accounting Procedures, https://smallbusiness.chron.com/seven-internal-control-procedures-accounting-76070.html, January 25, 2019

[11] That is, an adequate system of organization that clearly establishes and delimits authority and responsibility functions of business, bookkeeping and supervision.

[12] It includes planning and cost accounting system, chart of accounts, procedures and transaction flow chart.

[13] As a permanent body of the company's management, the internal audit is charged and responsible for constantly examining, evaluating and improving internal control.

[14] Personnel with the ability and experience to enable them to satisfactorily perform the tasks assigned to them.

[15] Internal Controls, Audit & Advisory Services, University of California San Francisco, https://audit.ucsf.edu/internal-controls#Internal%20Controls%20Summary, 2022 The Regents of the University of California,

[16] Enterprise Resource Planning (ERP): Meaning, Components, and Examples, The Investopedia Team,

ERP systems are used in all processes necessary for the functioning of the company - personnel and customer management, finance, production, availability of materials or products, delivery systems (delivery), services, orders and much more. In short, ERP combines all these processes and activities into one system, giving you a clear picture in real time. Improved productivity, increased efficiency, optimized costs and simplified processes are just some of the key benefits of an ERP system. Enterprise resource planning (ERP) is a type of software that organizations use to manage their day-to-day activities, such as sales, procurement, and managing all other operations. ERP systems are used to connect multiple business processes and enable the exchange of data between them - for this purpose, they collect common data of the organization from multiple sources. ERP systems eliminate duplication of information and provide a complete business picture on one platform.

V. Results of empirical research

Internal control mechanisms in organizations should be a key element in the improvement of organization management. These mechanisms exist to prevent and detect mistakes by employees, customers, suppliers, and even managers themselves. Unfortunately, many companies do not have good internal control systems, or they implement their internal controls inadequately.

If the management has planned and designed internal controls in such a way that they reasonably provide assurance that organization's risks will be managed effectively and that organization's goals will be achieved efficiently and economically, then it is considered that adequate controls have been established. In following survey, we will present results of the conducted empirical research on the effectiveness of management in internal control mechanisms implementation on a sample of 15 business organizations of Tripoli.

About 400 questionnaires were sent to 15 business entities in Tripoli. We managed to compile a representative sample of 220 respondents, employed in those organizations. This research included large representation of internal audit experts aproximatelly 35%, a large share of financial experts (accounting, controlling, operational finance) almost 30%, that represents a 65% of all respondents. A large number of managers of the first and second management level participated in the research, that leads us to a conclusion that the answers were given by competent person.

This research is planned to consider different degrees of development of corporate governance mechanisms in organizations. Intention was to determine representation and application of internal control mechanisms in different organizations. Application of these mechanisms provides improvement in management process.

Main two types of controlling are planning and reporting. To the question how do they establish an internal audit plan, the respondents answered: using a methodology based on assessment risk 76%, checking the plan of previous years 43%, management requirements 35%, while the internal audit plan does not exist in 11% of cases. The analysis indicates a relatively low level of quality of planning in the observed organizations.

To the question of whether there are pre-defined reports on the implementation of plan in their organization, about 41% of the answers were "yes" and 32% of the answers were "mostly yes". These answers give us an idea of presence of systematic process in the surveyed organizations.

At the question "Does the company have internal auditors and an organized system of internal controls? " more than 58% of organizations answered positivelly. Of those respondents, more than 90 percent answered affirmatively to the question whether internal auditor independently acts when performing its work. All respondents who answered this question think that the internal auditor acts independently and gives objective assessments and recommendations. In the largest number of cases, 62%, internal audit is organized as a separate department, and then in 35% of cases as an independent executive internal auditor.

The number of internal auditors per organization is diverse, ranging from one internal auditor in 59% of cases, 27% of organizations have 2 to 5 internal auditors, and 14% of organizations have more than 5 internal auditors.

Adequate supervision and evaluation is necessary to achieve the best possible quality of internal control work, in this survey 87.9% respondents answered that the internal audit service is adequately supervised. In most organizations (73%), internal auditors believe that they have appropriate access to the administration and management of the organization.

One of the crucial questions for this research is the cooperation of the internal audit with the external auditors in obtaining audit evidence and in providing direct assistance to the external audit with the guidance, supervision and review of the external auditor. Based on the results, we conclude that the cooperation between internal audit and external audit is better if they have adequate resources for work. If the internal audit approaches its work unhindered and has all the conditions for the quality implementation of the internal audit process, the external auditors will take more into account the quality of the implemented process, and therefore the use of internal auditors to ensure assistance in conducting the analysis of financial statements

To the question : Does the manager accept and implement the agreed recommendations of the internal audit?, 48.1% of the respondents gave afirmative answers. This fact indicates that companies still in insufficient measure, accept and implement the agreed recommendations of the internal audit. The reason for this, may be the fact that the management of the company has not yet fully understood the importance of internal audit for improvement of business processes in the company.

70% of organizations adhere to international internal audit standards in their work, 22% partially adhere to some standards, while 8% do not adhere to the standards. Also we came to the conclusion that organizations presents annual reports: 47% based on the risk assessment methodology, 24% on the basis of checking plans from the previous year, 29% on the basis of management or audit committee requests. Measurements of the performance of internal audit activities are carried out to the greatest extent:

https://www.investopedia.com/terms/e/erp.asp, September 10, 2022 through accepted recommendations (41%), followed by the execution of the audit plan(32%), while in 27% of organizations there is no formal measurement of internal audit activities.

To the question whether internal audit reports are available and presented to employees in the areas to which the report refers, less than 50% of respondents gave positive ratings. In order to be enforceable, the recommendation must be clear and accessible to all interested parties in the process of managing goals and risks.

To the qestion if internal audit reviews business activities and programs to determine whether the results are in accordance with set goals, almost all respondents answered positive.

Also more than 90% of respondents had a positive response to the claim that internal audit determines the adequacy and effectiveness of internal accounting and operational systems control in the organization.

In most surveyed organizations (86,7%) internal audit checks the accuracy and reliability of financial reports, and also reviews compliance with policies, plans, procedures and regulations. The most of the responses were affirmative to the statement that internal audit verifies compliance with applicable external laws and regulations.

Internal audit considers means of asset protection (79% of afirmative answers), and considers economical, effective and efficient use of resources (more than 84% afirmative answers).

VI. Conclusion

Analyzing the answers to the question if internal audit evaluates and improves the effectiveness of risk management, one final conclusion is made: more developed internal control in company and the higher level of assurance as activities of internal control, risks are managed more effectively.

The results, obtained by analyzing the responses of surveyed companies, indicate that internal controls mechanisms in a large number of these companies are successful in achieving their goals. Based on a high average score for each objective of the internal controls, it is concluded that the design and functioning of those controls is satisfactory.

Bearing in mind that the definition of internal control is not a guarantee of its successful functioning, it is extremely important that the company's employees understand the importance of its implementation. Examining the attitudes of companies on the basic control activities and their analysis, obtained results indicate that the majority of companies recognize the importance of the implementation of controls, that is important for the effectiveness of the internal control. Legislative regulation of internal control mechanisms in Libya has gained more and more importance in the last ten years. With the transition in prevailing market regulation of economic relations, there is also the emergence and implementation of internal control mechanisms in accordance with international business practice.

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