

Internal control and internal audit

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1- The concept of internal control:

The concept of internal control is due to its effective role in verifying that all the company's business is carried out in a manner consistent with the policies and strategies set by the Board of Directors.

This is in addition to the company having sufficient policies that make it reassure that all transactions take place within the appropriate authorities, that assets are maintained, and that all liabilities are monitored and under control, in addition to the flow of information in a sound and timely manner, and that the company's management is able to evaluate, manage and control the Work risks.

2- The relationship of control with management

Internal control is one of the important components of the administrative process, as control aims to ensure the achievement of the desired goals in accordance with the established policies, and to ensure good performance, adequacy of operations, the effectiveness of decisions, identifying deviations, and working to evaluate them, which is positively reflected on administrative and financial decision-makers.

3- The internal control system and its stages of development:

Establishing an effective and sound system of internal control is the responsibility of the company management, and it is also its responsibility to maintain this system and ensure the safety of its application.

There is also a legal obligation for the administration to keep regular accounts that enable it at the end of the year to make financial statements to show the results of its business and its financial position, especially in the case of public institutions and shareholding companies. It is not reasonable to have regular accounts without a sound system of internal control.

The concept of internal control has been affected by the development of the size of the companies, and the availability of rational management for these companies, and this development was as follows:

The first stage:

Where the prevailing form of projects is the individual establishment, and the interest of the owners of these establishments to protect cash, and then the definition of internal control receded on the set of means that ensure the preservation of cash from theft and embezzlement, and then extended these means to include some other assets, the most important of which is inventory.

Since the establishments in that period were striving to achieve the highest value of profits, which was a basic measure of competition between establishments, the internal control was aimed at protecting assets and funds, and ensuring the accuracy of accounts, which is a sufficient task for that economic stage.

The second stage:

With the expansion of the size of companies, and the accompanying inflation in their administrative and supervisory operations, the definition of internal control has evolved to include a set of means and procedures that help reduce the potential for errors and fraud in addition to protecting cash and other assets and encouraging adherence to administrative policies.

At this stage, the traditional concept of internal control, which was mentioned in the aforementioned first stage, is skipped, to include the addition of accounting functions, and other control functions such as control with budgets, standard costs, production efficiency reports, statistical analyzes related to the study of time and movement, and performance reports.

Hence, the objectives of internal control in the second stage can be summarized as follows:

- A- Protecting the company's funds and assets from error, fraud and misuse.
- B- Ensuring the accuracy of the accounting data recorded in the books and contained in the financial statements.
- C- Improving production efficiency and reducing costs, by encouraging workers to adhere to the established administrative policies.

Third stage:

The emergence of large companies, cross-border companies, the emergence of global financial markets, the tremendous economic development, and the accompanying complexity of administrative and supervisory processes, the delegation of authorities, and the increased interest in achieving the efficient use of the resources available to the company, in light of monopolistic competition, which made the profit measure unfair. It is sufficient alone to measure the efficiency of the company, and with the emergence of scientific management that seeks to achieve the maximum economic exploitation of the available resources, by reducing costs to the maximum extent possible.

Hence, the objectives of internal control in the third stage can be summarized as follows:

- 1- Calling for a clear organizational structure that defines the authorities and responsibilities, with appropriate means of coordination and communication.
- 2- Protecting the company's assets and properties from tampering, theft, and embezzlement.

- 3- Ensuring the accuracy of the accounting data, and their suitability for reliance on them in formulating policies and rationalizing administrative decisions. Encouraging production efficiency, by using the available resources in the production process at the lowest possible cost.
- 4- Encouraging employees to adhere to administrative policies and decisions, this helps in achieving the goals and plans set.
- 5- Advocating for improving performance through directing by objectives.

From the above, it becomes clear to us that internal control is divided into:

A- Control environment:

It means the general position of resources and management, their awareness and actions related to the internal control system and its importance in the company. The control environment has an impact on the effectiveness of some control procedures, and it alone cannot guarantee the effectiveness of the internal control system. There are influential factors in the control environment, including:

- 1- The performance of the Board of Directors and its committees.
- 2- Management philosophy and work style.
- 3- The organization's organizational structure and methods of assigning powers and responsibilities.
- 4- The administrative control system, which includes the internal audit function, personnel-related policies, procedures and segregation of duties.

B- Control Procedures:

Those policies and procedures adopted by the management mean adding the control environment for the purpose of achieving the special objectives of the company. The control procedures include the following:

- 1- Submitting reports and testing the identically.
- 2- Checking the arithmetic accuracy of the records.

3- Controlling the applications and environment of computer information systems.

From the foregoing, it can be concluded that internal control is a comprehensive system for all aspects of the activity in the company and at all administrative levels, as it includes the ways in which powers are delegated, and management responsibilities towards the various functions of the company, as well as the necessary programs for preparing various reports for all administrative levels that enable officials to monitor the various activities project in order to achieve the desired objectives.

4- **Internal control departments:**

Internal control is categorized into the following sections:

- 1- Administrative control.
- 2- Accounting control.
- 3- Internal auditing.

A- Administrative Control:

It includes the organizational plan, means of coordination, and procedures aimed at achieving the greatest possible degree of efficiency and productivity while encouraging adherence to policies that are directly related to the responsibility for achieving the goals of the organization, such as statistical statements and budgets, which are indirectly linked to the accounting and financial records, and it is the starting point for the accounting control report on operations.

As it is clear that the study and evaluation of the administrative control system as one of the branches of internal control, is an important part of the work of the auditor, as the targeted policies and plans drawn up by the management have a direct and effective reflection on the results of activities and the financial position of the company.

The presence of any deviations in the application of the drawn policies is strong evidence of errors or omissions and possibly fraud and forgery, which is reflected in the accounting accuracy of the financial operations and then on the financial position of the project, and from here it affects the auditor's

opinion about the extent to which these data are represented fairly and honestly for the center project financial.

B- Accounting Control:

It includes the organizational plan, all means of coordination, and procedures aimed at testing the accounting data known as books and records related to the protection of funds and the accuracy of accounting records and the degree of dependence on them. This type includes several methods, the most important of which are:

- 1- Recording transactions according to the double-entry system.
- 2- Use of control accounts.
- 3- Use of periodic audit scales.
- 4- Preparing the financial statements in accordance with generally accepted accounting principles.
- 5- Follow the system of authentication, whether with banks or clients.
- 6- Existence of a sound documentary system.
- 7- The presence of an internal audit department that enjoys independence and impartiality.

C- Internal control:

It includes the organizational plan and all means of coordination and procedures, aimed at protecting the project assets from embezzlement, loss, or misuse. The dynamic part of the internal control activity in its comprehensive sense, and provides evidence of accuracy and discipline.

5- Important considerations when designing the internal control system:

Specialized professional bodies, as indicated by international standards, as well as writers and researchers, have unanimously agreed that setting up a tight structure for internal control falls on the shoulders of the company's management.

And since effective internal control is an important pillar for the company that qualifies it to perform the tasks entrusted to it and at the same time it is a

barrier and prevents fraud or error and preserves its assets and properties from tampering or misuse.

It is natural for the administration to take into consideration the relationship between the degree of effectiveness of the control structure and the costs of designing this structure. The question that can be asked is, is there a relationship between the degree of effectiveness of the internal control structure and the costs of its application?

Some researchers showed this relationship using the cost-benefit analysis method, where he indicated that the administration should study and estimate the expected benefits as a result of applying the designed control system, and match these benefits with the costs of their application. If it is implemented, then the company must abandon some of the control procedures that are considered an additional cost, so as not to disrupt the essence of the control process.

Some believe that there are five basic elements that are taken into account when designing an effective system of internal control

1- **Providing the administration with the appropriate data:**

Since the administration must possess accurate information from the operations of the company, as making a decision requires the availability of a quantity of appropriate information to help the administration take the appropriate decision.

2- **Assisting the administration in maintaining the assets and records:**

Physical assets must be protected from misuse, theft or devastating accidents, through an effective control system, in addition to important records such as arrest papers or contracts concluded with third parties, incoming checks, and licenses, and the recording of various operations using a computer must be protected through saving this information in as many media as possible.

3- Encouraging the efficiency of operations:

This is done through the optimal use of available resources, and avoiding duplication of operations, taking into account the homogeneity of the costs of control operations with the desired benefits from these operations.

4- Enhancing the implementation of established policies and procedures:

It is aimed at achieving the objectives of the company by the relevant persons.

5- Observance of external regulations and laws:

Whether local or international laws that regulate the work of various establishments.

6- Factors that helped in the development and expansion of internal control:

Several factors have contributed to the increase in interest in the internal control system, and the most important of these factors are

1- The large size of the companies and the multiplicity of their operations:

The rapid growth in the size of companies and the diversification of their businesses through mergers, branching and natural growth have made it difficult to rely on personal communication in project management, and this has led to reliance on means that are at the core of internal control systems, such as analytical statements, budgets, division of labor and so on.

2- The administration's necessity to delegate the powers and responsibilities to some sub-departments:

The separation of the owners of capital in the shareholding companies from the management, in addition to the fact that the board of directors cannot carry out all the work entrusted to it, so it delegates some of its powers to subsidiary departments, and in order to release its responsibility to the shareholders, the board of directors achieves oversight over the work of

these departments through the means, standards, and procedures of internal control, which in turn leads to the management's reassurance about the safety of the work in the facility, hence the interest in internal control systems and the development of means and procedures that ensure the Board of Directors achieve its objectives.

3- The administration's need for accurate periodic data:

The existence of an internal control system makes the financial reports submitted to the management trustworthy, as it contributes to the appropriate decision-making process to correct deviations and formulate future policies.

4- The project management needs to protect and maintain project funds:

The existence of an effective system of internal control protects the management from its liability to shareholders and others, and therefore it must provide a series of procedures that work to protect and insure assets and property, and also works to avoid errors, waste, and negligence, and discover what may happen from that.

7 -Components of the internal control system:

The researchers in the field of auditing have unanimously agreed that the following basic ingredients are necessary to rely on the adequacy of internal control systems:

1- Administrative organizational structure:

The development of management science has an important impact on the administrative organization, especially in large enterprises that have multiple departments. A large number of these institutions have adopted the theory of powers so that the distance between the decision-maker and his implementer approaches, and this authorization must be accompanied by clear administrative procedures and effective control methods.

It also takes into account the simplicity and flexibility in the organizational structure, as well as clarity in terms of defining authority and responsibility, and the sequence of competencies and the main departments in it are clear,

while defining the authorities and responsibilities of these departments with complete accuracy.

2- The existence of an accounting system:

It depends on an integrated set of books and records, a classified directory of accounts and a set of documents that explain the needs of the project, in addition to designing documentary accounting cycles that achieve effective control in the stages in which the document passes possible.

3- Detailed procedures for carrying out duties:

The division of duties between the different departments must be taken into account so that one person does not monopolize an accounting or financial process from one to the other, as the combination of these stages poses a risk to the company in the presence of manipulation or embezzlement.

4- Selecting qualified employees and placing them in appropriate positions:

What this includes is an accurate description of the various functions of the company, and a decree program for training the employees of the company, to ensure their good selection, and to put the right man in the right place, so that the various competencies can be taken advantage of.

5- Performance control in project departments:

Where planned and drawn up performance levels must be adhered to, and if any deviation from these levels is found, it must be studied and procedures must be established to correct it.

One of the methods of performance control is the direct official's supervision of the work of those below him, or the use of various control tools, such as estimated budgets, standard costs, adequacy reports or internal audit.

6- Using automated means:

To ensure the correctness and accuracy of the accounting data recorded in the books and records, and to preserve the project's assets and assets from any manipulation or embezzlement.

8- The relationship of internal control with internal audit:

The internal audit contributes to tracking gaps and inefficiencies and reducing the number of risks, with the aim of verifying the availability of developed policies and procedures and verifying the company's commitment to them. Internal audit can be defined as “an element of the internal control system, set by the management of the facility with the intention of examining and evaluating, and then reporting on controls or accounting and other controls, which are practiced on operations, and are found either by an administrative decision or in some circumstances according to legal requirements.”

The need for an independent internal audit department is increasing, the more projects expand, their operations become complex, the issue of adequacy arises, the administration is forced to delegate authorities and responsibilities, and its need for periodic audited data, in addition to the need for the company management to protect project funds.

The effectiveness of an internal audit depends on the role played by the internal audit department and whether it is allowed to have great freedom of action and a reasonable degree of independence.

So that it achieves a set of goals, including:

- 1- To assure the management of the higher establishment of the smooth running of the project's operations, and to work in accordance with the established plans and policies.
- 2- Achieving effective control over the project's operations, in a way that achieves its objectives on the one hand and is considered one of the main pillars on which the external auditor depends on the other.
- 3- Reviewing the feasibility and efficiency of activities and verifying the operation of non-financial controls and controls.

- 4- Determining the abuses that the higher management cannot detect by normal means.
- 5- Ensure the accuracy of the financial reports flowing towards the senior management.
- 6- Verifying the implementation of the specified operations, especially those related to the implementation of other control procedures.

It can be said that the nature of the work of the internal auditor, as he lives the activities inside the facility, makes him have a lot of information, which qualifies him to be an important reference for data and information, and he has knowledge of the work that is available only to a limited number of people in the project, and this is what makes him able to carry out the work of a special nature.

Indeed, it has been proven that there is a relationship between internal and external auditing, as the external auditor should benefit from the work of the internal auditor.

The external auditor shall take the following criteria into account when relying on the internal audit:

A- Organizational Status:

Where the internal auditor is considered part of the company, and therefore may be exposed to obstacles while performing the work entrusted to him, and the external auditor must ensure the extent of the independence of the internal auditor and its subordination to the highest level of management, in addition to stripping him of operational functions.

B- Scope of tasks assigned to the internal auditor:

The external auditor must verify the depth of the tasks performed by the internal auditor, the seriousness and importance of the recommendations made to management, and the extent to which the management takes these recommendations.

C- Technical competence:

The external auditor must ensure that the internal auditor has the scientific and professional competence and the appropriate training that qualifies him to accomplish the tasks entrusted to him.

D- To exercise adequate professional care:

The external auditor must verify that the internal auditor is planning his work, documenting it properly, and using appropriate working papers.

9- The relationship of internal control to the accounting system:

The company needs a necessary accounting system for the conduct of the business, and for recording the facts that occur as a result of its normal activities, for which it was established.

The accounting system, in its simplest form, may consist of an analysis book for cash, books for invoices and dispatches, a ledger for creditors, and another for indebtedness, and this system may be consistent in the case of small-sized enterprises, but the large size of the projects, the multiplicity of its branches, the diversity of its products, and a large number of owners, which results in the verification and verification of the accounting system, and its suitability as a base for processing accounting information by recording the various operations of the company.

The accounting system is represented in “a set of documents and records, a proper classification of accounts, periodic reports and financial statements that include the financial data and information necessary for decision-makers.”

In order for the information provided by this system to be effective, it must be characterized by the following criteria:

1- Compatibility:

It is a method for measuring the quality of the evidence, the degree of its relevance to a certain assertion, its reliability, and its ability to influence decision-makers.

2- Credibility:

It means that the accounting data are affected by the extent of their reliability and their ability to clarify and accurately measure accidents, and to indicate their impact on the financial results.

3- Neutrality:

It means that the financial statements must reflect the real aspects of the activity without bias, and these data and information must be complete and clear.

4- Comparison:

It is an important characteristic in financial data and information, which is prepared on acceptable accounting principles, practices, and concepts so that it makes these data comparable from one year to another or one project to another.