

Internal Control: Is it a Benefit or Fad to Small Companies? A Unites States Model

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Introduction

- ❑ The purpose of this study is to discuss the challenges small companies face to implement internal controls and to examine the relationship of internal controls in companies and (a) fraud, (b) mistake, and (c) waste.
- ❑ The goal is to seek valuable ways of increasing companies' efficiencies through the effective integration of best business practices that are consistent with the COSO Internal Control Integrated Framework.
- ❑ One hundred and seventeen employees were selected through random sampling, and multiple regression and exploratory data analysis, including descriptive statistics, were used to analyze the data.
- ❑ The following logistic regression model summarizes the variables and design of the study
- ❑ $INTCRL = \beta_0 + \beta_1 FRAUD + \beta_2 MISTAKE + \beta_3 WASTE + \beta_4 SIZE + \varepsilon$

Background

Internal control is defined in this study as all the policies and procedures management uses to ensure the reliability of financial reporting, compliance with laws and regulations, and the effectiveness and efficiency of operations.

Fraud is an intentional action by management or employees that results in misstatement of the financial statements (financial statement fraud and defalcation).

Mistake is an unintentional action by management or employees that results in misstatement of the financial statements.

Waste is the use of company resources carelessly, extravagantly, or to no purposes in achieving organization objectives.

Background

Internal control has been an integral part of businesses for centuries, but confusion exists over the exact meaning and scope of the term (Apostolou & Crumbley, 2008). Historically, the term *internal control* applies to the domain of accounting and its efforts to safeguard assets and ensure the accuracy of accounting records (Apostolou & Crumbley, 2008). According to Grandell (1977), internal control began with the earliest known records of commerce in the Mesopotamian Valley in 3500 B.C.E. and continued through the Middle Ages. Edler (1934) purported that in the absence of paper, tally sticks were used to conduct internal control activities. Unsplit tally sticks started as mathematical objects serving as mnemonic aids to counting (Kuter, 2009). In addition, tally sticks provided the earliest form of bookkeeping for record keeping (Baxter, 1989). Although evidence of the practice of internal control can be traced back to 3500 B.C.E, little has been written about it by scholars as a discrete subject (Apostolou & Crumbley, 2008). Since the early 1900s, accountancy writers have paid more attention to internal control and its effect on organizations (Grady, 1957).

Research Questions

- The following research questions were answered based upon the results of the statistical analysis:

RQ1. What is the nature of the relationship between fraudulent activities and the internal control systems in your company?

RQ2. What is the nature of the relationship between errors (mistake) and the internal control systems in your company?

RQ3. What is the nature of the relationship between waste (shrinkage) and the internal control systems in your company?

Hypotheses

The following hypotheses were tested in order to answer the research questions:

Null Hypotheses

- H_{01} : There is not a significant relationship between employees' perception of fraud, and their perception of the internal control systems
- H_{02} : There is not a significant relationship between employees' perception of mistakes, and their perception of the internal control systems
- H_{03} : There is not a significant relationship between employees' perception of waste, and their perception of the internal control systems

Hypotheses

The following hypotheses were tested in order to answer the research questions:

Alternative Hypotheses

- H_{a1} : There is a significant relationship between employees' perception of fraud, and their perception of the internal control systems
- H_{a2} : There is a significant relationship between employees' perception of mistakes, and their perception of the internal control systems
- H_{a3} : There is a significant relationship between employees' perception of waste, and their perception of the internal control systems

Theoretical Framework

COSO INTERNAL CONTROL INTEGRATED FRAMEWORK

Control Environment

Control Activities

Risk Assessment

Information and Communication

Monitoring

Theoretical Framework

- The Committee of Sponsoring Organizations of the Treadway Commission ([COSO], 1992) created a common internal control model against which companies and organizations may assess their control systems. COSO described the five components of the framework as control environment, risk assessment, control activities, information and communication, and monitoring. COSO described the components as follows:
- Control environment. The control environment is the core of the business. It includes the people; their individual attributes of integrity, ethical values, competence; and the environment in which they operate. They are the foundation upon which the entity functions.
- Risk assessment. The entity must be aware of and deal with the risks it faces. It must set objectives that are integrated with sales, production, marketing, and financial and other activities so that the organization is operating in concert. It also must establish mechanisms to identify, analyze, and manage the related risks.

Theoretical Framework

- Control activities. The entity must establish and implement control policies and procedures to ensure that the actions identified by management that are necessary to address risks to achieving the entity's objectives are carried out effectively.
- Information and communication. Surrounding the control activities are the information and communication systems. These systems enable an entity to capture and exchange the information needed to conduct, manage, and control its operation.
- Monitoring. The entire process must be monitored, and modifications must be made as necessary. In this way, the system can react dynamically, changing as conditions warrant.

Mode of Survey Administration

The researcher employed face to face and telephone survey as research tools for the data collection for this study. The reason for choosing these survey methods were:

- Centralized quality control over all aspect of the data collection
- It requires less time
- The survey is completed quicker
- Higher response rate

Data Analysis

- Linear regression analysis was used to analyze data
- Data analysis were conducted through exploratory analysis using descriptive statistics and charts.
- Data were assessed by testing the hypotheses listed.

Answering the Research Questions and Hypotheses

- RQ1. What is the nature of the relationship between fraudulent activities and the internal control systems in your company? Use Hypotheses 1 through 3. Multiple regression analysis was used ($p = 0.000$). Predictor of the dependent variable
- RQ2. What is the nature of the relationship between errors and the internal control systems in your company? Use Hypotheses 1 through 3. Multiple regression analysis was used ($p = 0.000$). Predictor of the dependent variable
- RQ3. What is the nature of the relationship between waste and the internal control systems in your company? Use Hypotheses 1 through 3. Multiple regression analysis was used ($p = 0.000$). Predictor of the dependent variable

Summary of the Results

Null Hypotheses

H_{01} : There is not a significant relationship between employees' perception of fraud, and their perception of the internal control systems **Rejected**

H_{02} : There is not a significant relationship between employees' perception of mistakes, and their perception of the internal control systems **Rejected**

H_{03} : There is not a significant relationship between employees' perception of waste, and their perception of the internal control systems **Rejected**

Summary of the Results Contd.

Alternative Hypotheses

H_{a1} : There is a significant relationship between employees' perception of fraud, and their perception of the internal control systems. **Accepted**

H_{a2} : There is a significant relationship between employees' perception of mistakes, and their perception of the internal control systems. **Accepted**

H_{a3} : There is a significant relationship between employees' perception of waste, and their perception of the internal control systems. **Accepted**

Summary of the Results Contd.

The response rate for the study was 9.97% of the 270 managers surveyed 117 responded.

	Mean	Std Deviation
• Internal control	2.97	1.17
• Segregation of duties	2.89	1.02
• Protection of Assets	3.31	1.12
• Verification of Transactions	3.10	1.26

	Inadequate Control	Adequate Control	Total
• Internal Control	77 (66%)	40 (34%)	117
• Segregation of Duties	92 (79%)	25 (21%)	117
• Protection of Assets	74 (63%)	43 (37%)	117
• Verification of Transactions	77 (66%)	40 (34%)	117

Discussion –Interpretation of the Findings

- **Research Question 1:** There was a statistical significant relationship between fraud and internal control systems. It could be concluded from the data that if employees perceived internal control system to be effective, fraudulent activities (deviant) are less likely.
- **Research Question 2:** There was a statistical significant relationship between mistake and internal control systems. It could be concluded from the data that if employees perceived internal control system to be effective, mistakes (deviant) are less likely.
- **Research Question 3:** : There was a statistical significant relationship between waste and internal control systems. It could be concluded from the data that if employees perceived internal control system to be effective, waste (deviant) is less likely.

Thanks

- Thank you for your time and for listening
- Q/A