

## The Structure and the Role of the System of Internal Control for Purposes of Audit

*A.N. Ustinova, V.V. Pokidova and N.V. Zenina*

Volgograd branch of Moscow University of Finance and Law, Volgograd, Russia

---

**Abstract:** This article discusses the basic concepts of internal control, its environment, structure and procedures. Limitations of accounting systems and internal control are also presented here. The authors consider audit of internal control system, which is used to determine the level of the confidence that the auditor can render to the controller of the audited entity. In its turn, the system of the internal control includes the control environment, which means the awareness and actions of the audited entity, aimed at establishing and maintaining of the internal control. The evaluation of the internal control is to obtain views on the shortcomings of control of the economic entity. The authors also appraise the efficiency of the internal control system during the audit, its ability to eliminate and prevent errors.

**Key words:** Auditor • Audited entity • The external (independent) audit • Control environment • The accounting system • Internal control system

---

### INTRODUCTION

First of all, let's give the definition of the concept of the control system. Control system at enterprise consists of two components - a system of accounting and internal control system. Accounting system organizes and oversees the financial control and internal control system is a tool of management control. The internal control system usually permeates the accounting system. The accounting system is an element of the internal control system, which, in its turn, is a part of management system.

Each system performs certain functions: accounting system is designed to ensure the completeness, timeliness, consistency and reliability of data recording and reporting and the internal control is designed to identify, prevent and correct the error (data corruption).

Internal control in its modern sense is based on the principles Committee of Sponsoring Organizations of the Treadway Commission, published in the U.S. in 1992 in Internal Control-Integrated Framework [1].

The importance of this concept-in its presentation the basic concepts and key elements of internal control. There is an emphasis on the responsibility of the organization's leadership for its activity.

So, control can be referred as internal check, internal control and internal audit but the objective of all is to get work done efficiently and effectively without the wastage of economic resources of company [2].

Internal controls and audit are the main part of the modern management system, trying to achieve established goals with minimum expenses [3].

For the purposes of an external (independent) audit the internal control system is a set of organizational policies and procedures that are used by a manager of audited entity, as means for the orderly and effective implementation of the financial and economic activities of the organization, to identify, correct and prevent errors and distortion of information, the safeguarding of assets, as well as the timely preparation of reliable analytical information.

Most authors, describing the audit, determine the internal control system in accordance with the extrapolation of the regulatory framework of the audit and not merely with its logical destination.

For example, T.V. Mirgorodskaya argues that the auditor should refer to the accounting system, to study the organizational structure of departments, to consider the organization of training documents and methods of data processing, etc. if he/she wants to evaluate the internal control system [4].

In practice, therefore, the internal control system is largely confined to internal audit or equals to the organization of the accounting process or proper accounting processes.

Perhaps this is due to the fact that there is no expressed internal control in many organizations due to the specificity of the size and management structure and monitoring functions are distributed among the organizational management participants which is also contrary to the principle of independence of any kind of control. For example, Sidney J. Gray and Belverd E. Needles cite the system of accounting, control environment and individual controls as components of the internal control [5].

Thus, the internal control system may be directly attributed to an accounting system and includes a control environment.

## **MATERIALS AND METHODS**

The authors use in the article a lot of theoretical and practical sources and materials of Russian and foreign origin in the sphere of system of internal control for purposes of audit.

As for scientific methods, authors use method of comparative analysis, method of qualitative analysis of scientific sources and literature, method of system analysis.

## **RESULTS AND DISCUSSION**

Internal control in the overall presentation is a control (by management) in the enterprise. By functions internal control is classified in the following way:

The main task of control is increasing efficiency, which is achieved by ensuring the accuracy of data and the possibility of quick access to data [6].

The notion of the internal control system is given in the FSA # 8: "The assessment of the audit risk and the internal control, realized by the entity".

Control environment is a set of actions by a manager of an audited entity that are aimed at establishing and maintaining of the system of the internal control, as well as understanding the importance of such a system.

The control procedures adopted by the management of the audited entity include:

- Accountability of employees with others;
- Internal audits and verification of data concerning financial and economic activities;

- Comparison of audit findings of the actual availability of assets and liabilities with an accounting (financial accounting);
- Comparison of the information received from internal sources with external sources of information data;
- Verification of analytical accounts and current statements and mathematical accuracy of records;
- Verification over applications and computer information systems, including the establishment of control over changes of software and access to the data files for the right of access at input and output and the formation of the system;
- Restriction of access to assets and records;
- Comparison and analysis of financial results with planned targets.

To define the boundaries of the system of internal control, it is necessary to form a working group to develop inspection method and make a planned schedule. It is possible to include in its structure the internal auditor and analyst as well as expert leaders managers of the functional units in order to implement control procedures [7].

The level of the reliability of financial statements has two aspects. The first aspect is an accounting-a compliance of accounts and records with the regulatory documents and rules of Russian Federation. The second aspect of reliability is economical. The accuracy of reporting is an adequate reflection on the economic activity [8].

The evaluation of the internal control is the procedure for obtaining representations about the shortcomings of the economic entity's controls. The Auditor, evaluating internal control and accounting system, determines how these systems are able to fulfill their functions: detection, correction, prevention and prevention of errors in accounting and reporting. The auditor determines how he can rely on the system of internal control audit.

The study and the evaluation of internal control and accounting, as well as risk assessment of these systems is carried out in the preparatory stage of the audit. At this stage, the auditor assesses the control system, determines the extent of audit and audit sampling and he/she also defines the permissible level of materiality and audit risk for a particular test. According to the preliminary procedures a common audit plan is drawn up and audit programs are formed on specific sections of the audit records.

The objective of assessment of the accounting and internal control is to ensure the planning stage with confidence that the company has a system of control, that is to say the control system (a system of accounting and internal control), organized by the company carries out its functions properly. An important function of the control should be ensurance of safeguarded assets and their intended using.

The internal control system performs the following functions: detection, prevention and corrections of errors (distortion). Control facilities related to the accounting system, contribute to the achievement of these goals. The method of assessing, used for achieving the control objectives of the control environment is created in the enterprise.

The control environment is created to be the awareness and actions of the management of the economic entity, aimed at establishing and maintaining internal control. It includes such items as:

- Leadership style;
- Organizational structure of the enterprise;
- Recruitment policy of the company;
- Management control system for the formation of accounting and financial statements.

There is no guarantee that the systems are able to fulfill their functions by reason of the limitations of the accounting system and internal control. Limitations of the system include:

- The cost of software systems should not be higher than the expected benefits;
- Controls are focused on current, not unusual transactions (namely atypical business transactions are the cause of significant errors, unusual transactions are not systemic in nature and may be omitted by the control system);
- Control system because of its imperfections may miss both random and systematic errors;
- It is always possible to bypass the internal control procedures by people knowing their strengths and weaknesses.

The controller, wishing to assess the condition of the control environment, should gather information about the system of the internal control. Received information about the state of the control environment can be carried out using a special form of a working document auditor (test, a questionnaire, containing a list of criteria

upon which the internal control system is checked). In assessing of the internal control system for each factor of the system efficiency (criteria), the auditor selects one of the possible characteristics of impact factors - such as high, low or average - in accordance with the actual situation of the enterprise. Weak influence of the factor means that the indicator of the system of internal control is ineffective, but high value is effective on the contrary. The qualitative assessment (high, medium, low) can be replaced by a quantitative estimation when reliability (efficiency) for each factor is evaluated in points. However, the subjective opinion of the auditor can't be completely eliminated in this case, as the auditor's judgment is the basis for assessment, so it is important to allow the competent professionals, following auditing standards to conduct an audit.

The initial assessment of the accounting system of the audited entity may be carried out in the same way. The auditor can prepare tests of control and accounting for each section of the cycle accounting or business operations of the audited entity.

The auditor conducts the assessment of accounting systems and internal controls testing methods of control. Preliminary assessment of control risk is the process of determining of the effectiveness of the accounting and internal control entity for the possibility of preventing, detecting and correcting material misstatements. After assessing the accounting systems and internal controls, the auditor should make a preliminary assessment of control risk at the assertion level of the financial (accounting) statements for each significant section of balance sheet.

The auditor estimates the control risk as high, if the accounting system and internal control system of the audited entity are ineffective or have not been estimated. If the assessment of the accounting system and the internal control system allows discussion about their effectiveness, the auditor is required to justify such an assessment and to reflect this in the working papers.

The higher is the level of the inherent risk and control risk, the more audit evidence the auditor must gather in the course of substantive procedures.

If the inherent risk and control risk are assessed as high, the auditor should determine if substantive procedures can provide sufficient audit evidence to reduce detection risk and therefore the audit risk to an acceptably low level. In that case, when the auditor determines that the detection risk in relation to the prerequisites of financial (accounting) statements with respect to a significant account balance accounting or

group of transactions can't be reduced to an acceptably low level, he/she should express a qualified opinion or refuse his opinion.

Thus, the auditing process of the financial (accounting) statements is providing to concentrate only on the auditor's main objectives and specific procedures in the accounting system and internal control system that are relevant to the preparation of financial statements (accounts).

The effectiveness of the internal control system is measured as an ability to eliminate and prevent errors.

On the basis of evaluation of the effectiveness of internal control system by means of tests of controls, the external auditor evaluates one of the components of audit risk (risk controls) and draws conclusions about the possibility of using the results of internal controls for audit purposes on the basis of evaluation of the effectiveness of the accounting, the auditor also gives an initial assessment of the other component of the audit risk-inherent risk.

If the auditor can't evaluate the system of internal control, then he recognizes this system is obviously inefficient and the control risk is high.

Evaluating the effectiveness of the internal control system is not an auditor's service and the study of the internal control system during the audit is necessary to assess the risks of material misstatement due to fraud or error [9].

In the process of developing an approach to audit, the auditor considers the preliminary assessment of control risk and inherent risk assessment to determine the following important in the audit and characteristic checks, defined by the auditor:

- Risk of not finding appropriate information in premises of the financial (accounting) for the auditor;
- The nature, timing and extent of audit procedures on the merits.

However, the enterprise's internal control system can reach more diverse purposes than ensuring the proper functioning of the accounting.

## CONCLUSION

The internal control in an organization and an individual entrepreneur's internal control is a control system of any enterprise, which provides the implementation of plans and targets of the organization or entrepreneur.

## Therefore, the Main Objectives of Internal Control Are:

- Ensuring the organization is in accordance with the charts of plans, tactical and strategic objectives;
- Monitoring compliance with the organization's mission and the policy of leadership in all spheres of activity;
- Safeguarding of assets;
- Maintaining of quality documentation of transactions;
- Elimination and prevention of negative deviations in the organization.

The audit of the accounting and internal control consists in assurance of the planning stage with confidence that an organized system of control operates at the enterprise and performs its functions properly.

## REFERENCES

1. Committee of Sponsoring Organizations Treadway Commission (COSO), 1992. Internal Control Integrated Framework. - <http://www.coso.org/ic-integratedframework-summary.htm>
2. Abbas, Q. and J. Iqbal, 2012. Internal Control System: Analyzing Theoretical Perspective and Practices. Middle-East Journal of Scientific Research, 12(4): 530-538.
3. Modeler, R.E., 2009. Brink's Modern Internal Auditing: A common body of knowledge. 7th edition. Hoboken: Wiley & Sons, pp: 766.
4. Mirgorodskaya, T.V., 2008. Audit: Tutorial. 2nd edition. Moscow: Knorus, pp: 256.
5. Gray, S.J. and B.E. Needles, 1999. Financial Accounting: A Global Approach. Boston: Houghton Mifflin, pp: 599.
6. Vygonova, E.E., 2011. Methodology and the organization of internal control in enterprises. Vector of Science, Togliatti State University, 2(16): 348-350.
7. Khmelev, S.A., 2011. Establishment of internal control system in the sphere of economic security of the companies. Vector of Science, Togliatti State University, 1(15): 285-288.
8. Melnik, M.V. and V.G. Kogdenko, 2012. Economic analysis in the audit: Study guide. Moscow: Unity-Dana, pp: 543.
9. Kakovkina, T.V., 2011. Audit and evaluation of the internal control. Audit statements, 9: 3-9.